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One Issue: Two Covers

This issue of *Bloomberg Businessweek* has two covers on newsstands. Half are a "male" version of The Infidelity Economy, while the other half are "female." The content of both issues is identical.





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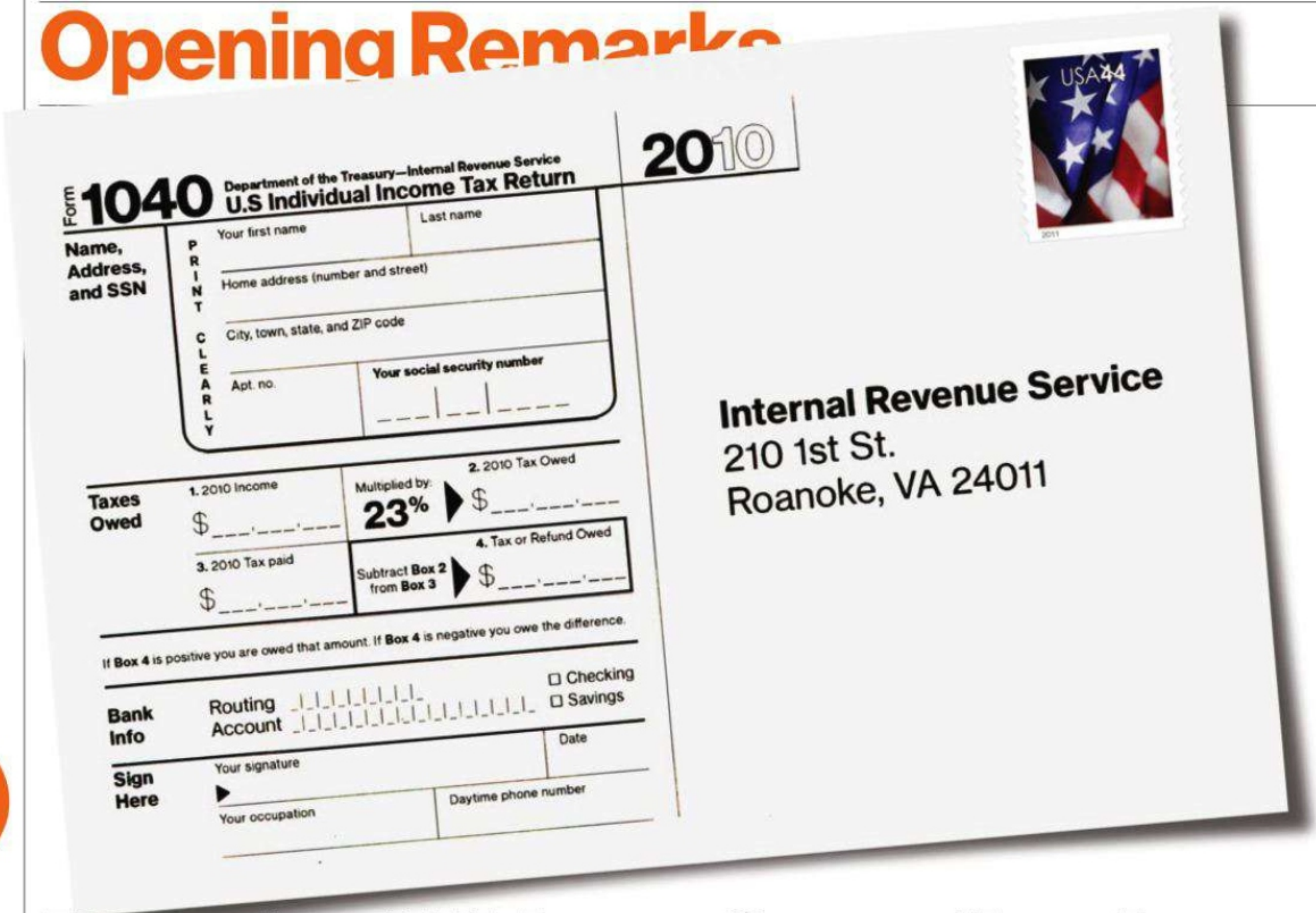
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Taxation Without Complication

It's time for Congress to zero out all the deductions and loopholes and start over

By Peter Coy

As Congress gears up for a rethink of federal tax policy, America is having a Chicken of the Sea moment. Like the actress Jessica Simpson, who famously didn't know what to make of her canned tuna—"Is this chicken, what I have, or is this fish?"—Americans are confused about deductions, exemptions, and other special treatments in the Internal Revenue Code. If Congress repeals a tax break to reduce the deficit, does that mean it's raising taxes and stealing money from your pocket? Or is it cleaning up a backdoor form of federal spending—what economists call a tax expenditure?

The positioning matters. Many Americans, not just those in the Tea Party, oppose any kind of tax increase, arguing that the budget should be balanced strictly through spending cuts. They don't trust government to use wisely the extra money it collects. That argues for leaving tax breaks in place. "To claim that forgone tax revenue is a government expenditure implies that the money at stake actually belongs to the government, which is graciously letting taxpayers keep it, rather than to the people who earned it," Michael F. Cannon, health policy studies director at the Cato Institute, wrote in a Cato blog last November.

Yet Americans also dislike special treatment for favored constituents, as National Taxpayer Advocate Nina E. Olson observed in January in her annual report to Congress. And they're skeptical of using the tax code for social engineering—steering people toward certain activities and away from others. That, along with the ballooning federal deficit, argues for repealing some of the tax breaks. Revenue carve-outs such as the home mortgage interest deduction are "simply spending in drag," says Howard Gleckman, resident fellow at the Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution. "It makes no economic difference whether you give somebody a subsidy through the tax code or you give them a subsidy via spending."

A trillion dollars a year rides on settling this chicken-or-fish confusion. If left untouched, tax expenditures of various kinds will reduce the federal government's revenue by about $5 trillion between 2010 and 2014 from what it would have been with no such breaks, according to the nonpartisan Joint Committee on Taxation. Repealing some of the

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breaks would allow the government to lower overall tax rates dramatically and still raise the same amount of money, or lower rates a little and raise a lot more.

Here's an idea: Stop the unproductive debate over how to characterize tax breaks and focus on what really matters—setting a tax policy that raises the necessary revenue in a way that's fair and simple, and doesn't discourage work, investment, and growth. Using those criteria, a lot of entrenched tax breaks would disappear. And the Alternative Minimum Tax—a hated tool to stop taxpayers from claiming too many breaks—would no longer be necessary.

The best way to begin thinking about this was put forward in November by Republican Alan Simpson and Democrat Erskine Bowles, co-chairmen of the National Commission on Fiscal Responsibility and Reform. Their most drastic option, the "Zero Plan," would eliminate every tax expenditure as well as the AMT and other encrustations. Doing so, they said, would let the government cut the top individual rate to 23 percent from 35 percent while bringing in $80 billion more.

It's not realistic to wipe out every tax break, but a clean slate is always a good place to start. It dangles the carrot of low rates in front of lawmakers, while exposing the cost of adding back tax breaks. Adding the earned income tax credit and the child tax credit, for example, would bump the top rate back up by one percentage point to 24 percent, according to Simpson and Bowles. Adding mortgage, health, and retirement benefits in addition, plus changing the taxation of international income, would force the top rate up to 28 percent. And so on.

On Feb. 3, the conservative website Daily Caller quoted Senator Saxby Chambliss (R-Ga.) as saying that he and Senator Mark Warner (D-Va.) would introduce a bill that started out with zero deductions and loopholes. But aides to Chambliss quickly said that nothing has been decided. The alternative to the clean slate—taking on tax breaks one at a time—is politically difficult because it doesn't share the sacrifices. Nobody wants to give up a break if the other guy gets to keep his.

The tax breaks now on the books range from worthy and necessary to silly to outright harmful. They also make the tax code murderously complex. Olson, the national taxpayer advocate who runs an independent unit within the IRS, estimates the cost of preparing returns and coping with tax laws at $163 billion in 2008—11 percent of income tax receipts. No one can hope to understand the entire code. The wealthy can get a tax credit for buying a $100,000 Tesla electric sports car, but Olson says that in 2006, 37 million ordinary taxpayers failed to claim a telephone excise tax credit of $30 to $60—apparently because the tax code was so complex they didn't know the credit was available. Olson, citing her obligation to advise Congress under "Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code," says all tax expenditures should be eliminated "unless a compelling business case can be made" for them.

Eugene Steuerle, who was economic coordinator of the Treasury Dept.'s tax-code-simplification effort from 1984 to 1986, says the country needs a repeat of that Reagan-era exercise. "The tax code has become a giant mess," says Steuerle, a co-founder of the Tax Policy Center. "We've got to dig ... and find out what works and what doesn't work."

Two tax breaks that many economists regard as costly and inequitable are the home mortgage interest deduction and the break for employer-provided health insurance. Because they benefit well-connected upper-income families, they will be very difficult to dislodge, Steuerle says.

> The highest earners receive the biggest average payoffs from most tax breaks. Of course, they pay the most taxes

Start with the mortgage break. According to the Joint Committee on Taxation, it cost $77 billion in forgone revenue in 2009, and provided close to $7,000 in tax relief on average to the highest-income families—compared with less than $2,000 in relief on average to all other families. (Renters, of course, get nothing.) Research by economist Edward Glaeser of Harvard University demonstrates that the break has little effect on homeownership rates because most of the benefits go to those who would buy houses anyway. Plus, it gives people an incentive to overborrow. To avoid unsettling the housing market, Glaeser advocates lowering the amount of mortgage principal on which interest payments can be deducted in gradual stages over seven years.

The break for employer-provided health insurance is doubly unfair. If you're lucky enough to have an employer that provides health insurance, you get the additional good luck of a tax break from the government. No employer-provided insurance, no tax break. Some people who do get employer-provided insurance cling to jobs that are wrong for them just to keep that benefit. And again, the people with the highest incomes get the biggest breaks. Forgone revenue? About $660 billion over five years, according to the Joint Committee.

To Congress, targeted tax breaks are like a drug; they please supporters and don't require appropriations. If a clean-slate look at the IRS code is ever to become more than a thought experiment, lawmakers need to go into tax rehab. **B**

—With Ryan J. Donmoyer

Tax Code Swiss Cheese

Tax rates have to be higher to make up for deductions, credits, and exemptions that reduce the government's take. Here are some key "tax expenditures" and who benefits most from them

	Total forgone revenue in 2009 (in $billions)	Benefit per return, below $200,000 income (in $)	Benefit per return, $200,000 income and above (in $)
Mortgage interest deduction	77	1,727	6,650
Earned income tax credit	55	2,139	NONE
Child tax credit	54	1,522	800
State and local income taxes, and personal property tax deduction	40	530	6,556
Charitable contributions deduction	35	491	4,738
Untaxed Social Security and Railroad Retirement benefits	24	881	505
Real estate tax deduction	21	544	1,963
Medical deduction	9	747	8,258

DATA: JOINT COMMITTEE ON TAXATION

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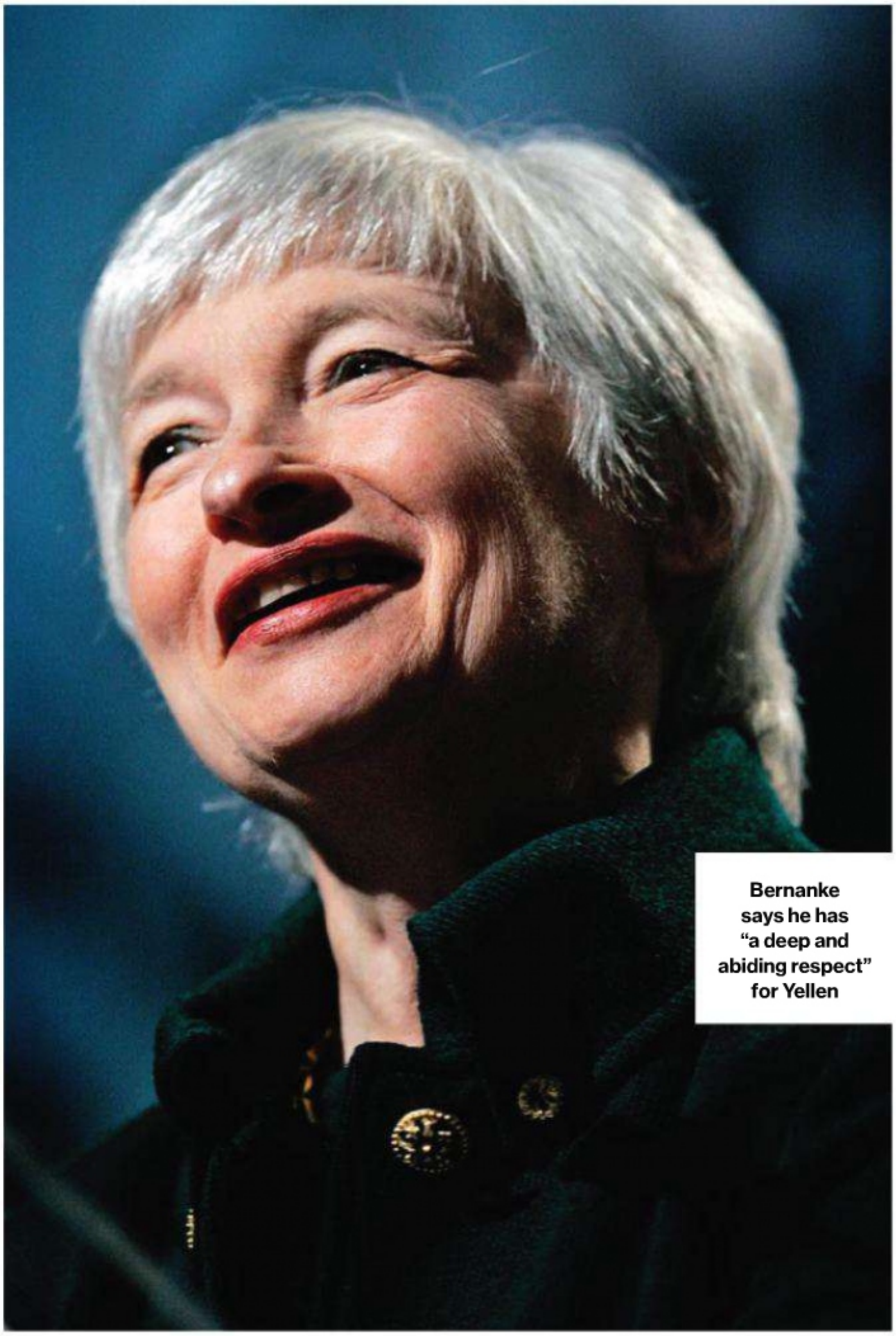
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An Inflation Dove Rises at the Fed

▶ Janet Yellen is serving as vice-chair of a Fed under siege

▶ "She is concerned about the cacophony of multiple voices"



Bernanke says he has "a deep and abiding respect" for Yellen

PAUL SAKUMA/AP PHOTO

Back in 1994, as the most junior Federal Reserve governor, Janet L. Yellen was the last to speak when Fed officials made their weekly presentations to the board about the economy. "Somehow we'd go around the table and then get to Janet and she would find a key issue in the briefing that others hadn't seen," says Donald Kohn, then a Fed official who was later vice-chairman of the board. Yellen went on to serve as President Bill Clinton's chief economist and as President of the San Francisco Fed. In October she succeeded Kohn as vice-chairman of the board at a time when the Fed is under fierce political attack–and as divided as it's been in decades.

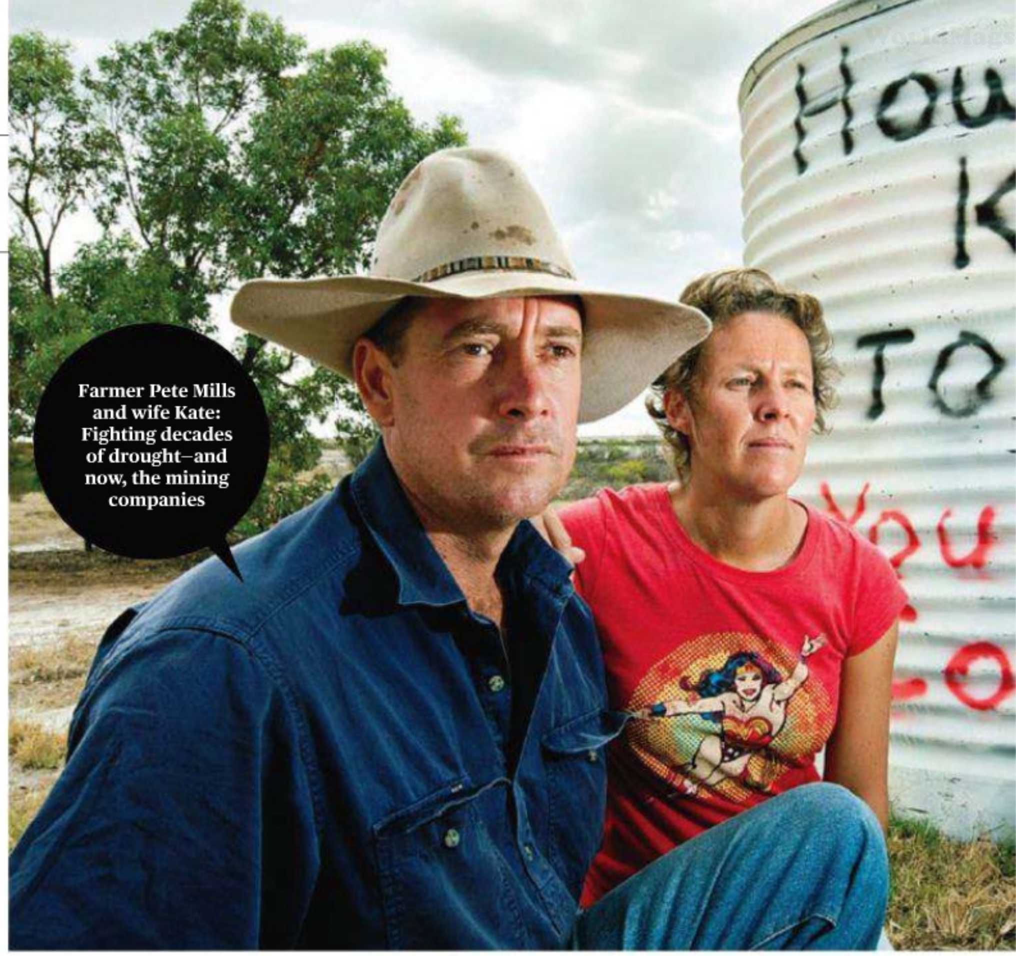
With commodity prices leaping higher, critics inside and outside the Fed have accused it of risking an outbreak of inflation by embarking on a plan to buy $600 billion of Treasury securities, a strategy Yellen strongly supports. On Capitol Hill, Representative Ron Paul, author of a book titled *End the Fed,* now heads a House financial services subcommittee on monetary policy. The Texas Republican criticized the central bank at a Feb. 9 hearing for failing either to contain inflationary pressures or reduce unemployment.

Yellen, 64, has the unenviable task of helping Chairman Ben Bernanke calm this storm. He has assigned her to head a communications subcommittee to figure out how to give the Fed a more unified public voice despite discord among its members. He also has put her in charge of a new group of economists and other Fed officials who will try to spot signs of a financial crisis before it occurs. "I've developed a deep and abiding respect for her judgment and skill as a policy maker," says the Fed chief.

The expected retirement of Kansas City Fed President Thomas M. Hoenig later this year will leave Yellen the only central bank member who was making policy during the last two times the Fed embarked on a credit-tightening cycle, in 1994 and 2004. That will give her opinion added heft in debates as the Fed weighs when to begin withdrawing the money it has pumped into the economy.

Yellen was born in Brooklyn, graduated from Brown University in 1967, and earned a doctorate in economics from Yale in 1971. She met her husband, Nobel prize-winning economist George Akerlof, at a lunch at

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Farmer Pete Mills and wife Kate: Fighting decades of drought—and now, the mining companies

the Fed in 1977 when she was a central bank official and he was a visiting fellow. Yellen spent most of her career teaching at Berkeley and researching labor markets. She and Akerlof have written papers on unemployment, wages, street gangs, and out-of-wedlock births.

Yellen says she went into economics because it provides a logical way to grapple with questions affecting human welfare. "I was of a generation that still was affected by the Great Depression," she says. "I didn't live through it, but my parents grew up during it." She has a reputation as one of the Fed's more dovish policy makers due to her concern about unemployment. She's a "fierce advocate" of the Fed's dual mandate to promote price stability and full employment, says Laurence H. Meyer, who served on the Fed board with Yellen in 1996 and 1997. Some Republicans believe the Fed should focus only on inflation.

Yellen says she feels "very comfortable" working at Bernanke's right hand; "my policy views I believe are very close to his." Former Fed Vice-Chairman Alan S. Blinder says he can imagine them disagreeing if Bernanke wants to raise rates to cap inflation at a time when unemployment is still high. For now, Blinder adds, that's not an issue, since Bernanke thinks inflation is too low.

Yellen's first challenge will be to sort out the communication issues bedeviling the Fed. "She is concerned about the cacophony of multiple voices seemingly contradicting one another," says Blinder, her co-author on a book about the economy in the 1990s. Yellen puts it more diplomatically. "Participants in the [Federal Open Market Committee] have a right to express their own views," she says. "We need to make sure, though, that the central message of what policy is comes across in a way that's not completely confusing." Although Yellen declined to give details, Fed officials have talked about holding press conferences for Bernanke at least four times a year after FOMC members update their economic forecasts, and issuing longer statements after policy meetings.

Philadelphia Fed President Charles I. Plosser says he would be concerned if the Fed adopted a communications strategy that stifled dissent. He says a public airing of the Fed's differences gives the country a truer picture of what's going on at the central bank. Plosser, who says he likes Yellen, will probably be on the other side of the debate when it comes to timing the next rate hike. He puts more emphasis on economic growth in assessing price pressures in the economy. The faster the economy grows, the bigger the risk of higher inflation and the greater the need to increase interest rates. Yellen focuses on slack, particularly in the unemployment rate. So if the economy is growing briskly but joblessness is still high, an inflation outbreak is unlikely.

Yellen says a lesson of 1994 and 2004 is that the Fed can't wait for unemployment to fall back to where it was before withdrawing stimulus from the economy. "You may have to take steps when it's not 100 percent popular to do so, to begin removing monetary accommodation when you don't judge the economy to be back at full employment," she says. "We know policy operates with a lag, and we have to make sure we act in a timely way." Yet Yellen seems in no hurry for the Fed to start tightening the monetary screws. "We want to be patient here," she adds. "We don't want to get ahead of where we should be."

—Rich Miller with Vivien Lou Chen

The bottom line *Janet Yellen, the Fed board's most prominent dove, wants the central bank to send a clear message at a time of internal dissent.*

Quoted

"How are we going to rein in government spending? We have really heard very little from the President. Now maybe he will open up with his budget. ... But he really has to lead here, and so far he simply has not."
—Glenn Hubbard, Dean, Columbia Business School



Natural Resources

It's Aussie Farmers vs. Chinese Companies

- ▶ In drought-stricken Western Australia, a struggle for water
- ▶ "I'm worried this new mine is going to take the water that's left"

A decades-long drought has seared the landscape of Western Australia, a state far from the floods that recently battered the eastern part of the country. Deprived of adequate rain for years, the region's farmers have managed to

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FROM TOP: RON D'RAINE/BLOOMBERG; JONATHAN FICKIES/BLOOMBERG

produce the biggest wheat harvests in Australia by relying more on aquifers–large underground reservoirs of water. Now farmers like Pete Mills are battling a Chinese company and its local partner for that water. "It's noticeably getting worse," says Mills of the drought. "I'm worried this new mine is going to take the water that's left."

The $1.8 billion iron ore project, a venture between China's fourth-largest steelmaker **Anshan Iron & Steel Group** and Perth's **Gindalbie Metals**, has applied to use water from the same underground supply that irrigates Mills's 4,000-hectare (9,880-acre) wheat and sheep farm. Anshan and Gindalbie's Karara mine is the first of at least eight iron ore projects planned for the state's Mid West grain belt in the next decade. Mines need water to help dig out and process the ore, remove waste rock, and suppress dust to meet air quality rules.

170bn

Dollar value of planned mining projects in Western Australia

"We haven't had many conflicts between mining companies and other water users in the past because there hasn't been a big mining industry in the Mid West," says Phil Kneebone, spokesman for Western Australia's government-run Water Corp., which supplies drinking water to communities. That's going to change as the mining companies, often backed by Chinese investors, open more mines. In Western Australia there are about $170 billion in mining projects in the pipeline over the next five years.

Gindalbie, the Australian company in which Anshan Steel holds a 35.9 percent stake, says it applied to use 5.3 gigaliters of the estimated 49 gigaliters (or 49 billion liters) available in the Parmelia aquifer, from which Mills and other farmers draw their water. "Karara has spent around $3 million conducting extensive tests on the aquifer and the sustainability of our water usage plans," Gindalbie corporate affairs manager Michael Weir wrote in an e-mail. When the mine starts, it will generate $363,000 of export revenue for the state for each megaliter of water used, he says.

The Gindalbie project will have access to one section of the aquifer. Mills says the mine will drain as much as 87 percent of that section of water. That, says Mills, will leave farmers with little. He is an active member of the Water Action Group, which is organizing petitions and protests against the mine's water allocation by the Western Australian government.

One aspect of the Gindalbie project that especially alarms the region's farmers is that the mine is for magnetite iron ore, says Mills. Magnetite is a lower grade of ore that needs more processing than the hematite found to the north in the Pilbara region. More processing requires more water.

The Chinese are settling in for the long haul. In the northern region of the state–far removed from Mills's farm and the planned Anshan/Gindalbie project–**Citic Pacific**, an arm of China's biggest state-owned investment company, has built a 51-gigaliter desalination plant to provide the fresh water for its $5.2 billion Sino Iron magnetite project. "Western Australia is a very hot, hard, and flat country on which it's hard to store water," says Peter Strachan, who heads Perth-based independent advisory firm StockAnalysis. "Processing these magnetite ores is going to be pretty greedy for water."

Sinosteel, China's biggest iron ore trader, is also developing a magnetite project in the Mid West part of the state. Australian regulators approved more than 100 Chinese acquisitions of businesses between November 2007 and October 2009, according to the Australian government.

It's up to the state's water authorities to approve Anshan/Gindalbie's request to use the Parmelia aquifer. State environmental regulators have already given the green light to the project. The planned Karara mine has "strong government support," Gindalbie said in a Jan. 31 statement.

More rain would help both the miners and the farmers. Figures from the government-run Bureau of Meteorology show a significant decrease in rainfall in Western Australia since the mid-1970s, according to bureau forecaster Patrick Ward. Dams servicing the area around Perth, the state capital, are less than 30 percent full. "The winter rains have become more unreliable, and that seems to be a trend that will continue," Ward says. "Some areas where agricultural crops are marginal might soon tip over so they're unsustainable."
—Jason Scott

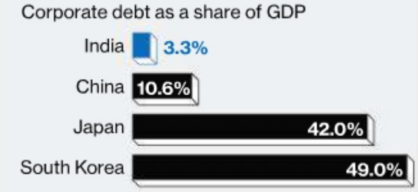
The bottom line *Farmers in the state of Western Australia are competing with mining companies for precious water supplies.*

Debt

India's Bond Market Needs to Bulk Up

▸ **Corporate bonds are only a small part of the economy**

▸ **India's Lagging Bond Market**
Corporate debt as a share of GDP



DATA: ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

Infrastructure Development Finance, a company formed by the Indian government to lend to energy and road projects, just sold 29.3 billion rupees ($640 million) in 10-year tax-exempt bonds. The sale closely follows **Indian Overseas Bank**'s successful issuance of 15-year debt. That's pretty routine in most countries. For India,

17

PERCENT

Share of U.S. consumers surveyed unable to afford medical bills or medication. That's up from 14.7 percent a year ago.

DATA: CONSUMER REPORTS TROUBLE TRACKER INDEX

though, the deals were encouraging to investors, who can't find enough Indian corporate bonds to buy, according to bankers who did not want to be quoted.

"India really needs to develop a bond market for long-term funding," says Michael Queen, chief executive officer of **3i Group**, Europe's biggest publicly traded private equity firm, which plans a $1.5 billion fund to invest in India's infrastructure in the next six months. "My biggest concern when investing in India is the availability of debt capital."

India's corporate bond market, about 30 percent the size of China's, is failing to expand at the rate analysts say is needed for the government to meet its target of building infrastructure. India has about $200 billion of corporate bonds outstanding, Bloomberg data show, compared with China's corporate bond market of $614 billion, according to Asian Development Bank figures.

Prime Minister Manmohan Singh has proposed about $1 trillion of investment in the five years through 2017 to upgrade the country's crumbling road and power networks, whose defects the Finance Ministry says shave 2 percentage points from growth. Singh plans to raise about 50 percent of the spending from private capital.

The best way to tap private capital for infrastructure is through long-term bonds, which offer fixed, predictable costs. "The success of the government's very ambitious infrastructure program hinges on developing an adequate bond market," says D.H. Pai Panandiker, president of RPG Foundation, an economic policy group in New Delhi. Though bank loans are more available than bonds in India, they're generally more expensive than bond offerings. Besides, bankers in India are reluctant to fund infrastructure projects since they take so long to pay off.

The government shoulders part of the blame for the corporate bond market's dwarfish status. Regulations raise the cost of issuing bonds and rules limit foreign investment. Pension funds and insurance companies–typically among the biggest buyers of corporate debt in other countries–are restricted in how much they can invest in bonds. That shrinks the potential market for the bonds and forces companies to offer higher rates to attract buyers.

Policymakers are trying to make amends. They've introduced credit default swaps so investors can gauge more accurately the risk of buying corporate bonds. Singh's government has also allowed foreign funds to buy more corporate debt and has introduced a 20,000-rupee tax exemption for investors buying bonds to support infrastructure projects.

More needs to be done. Allowing banks to guarantee bonds would lower companies' funding costs and increase investor confidence in the bond market. Lifting caps on foreign insurance and pension companies operating in India would broaden the investor base.

Even with these additional reforms, India would have a long way to go. Its outstanding corporate debt is only 3.3 percent of its gross domestic product, vs. 10.6 percent in China.
—Andrew MacAskill and Anurag Joshi

The bottom line *India needs to develop a more robust corporate bond market if the government's $1 trillion infrastructure program is to succeed.*

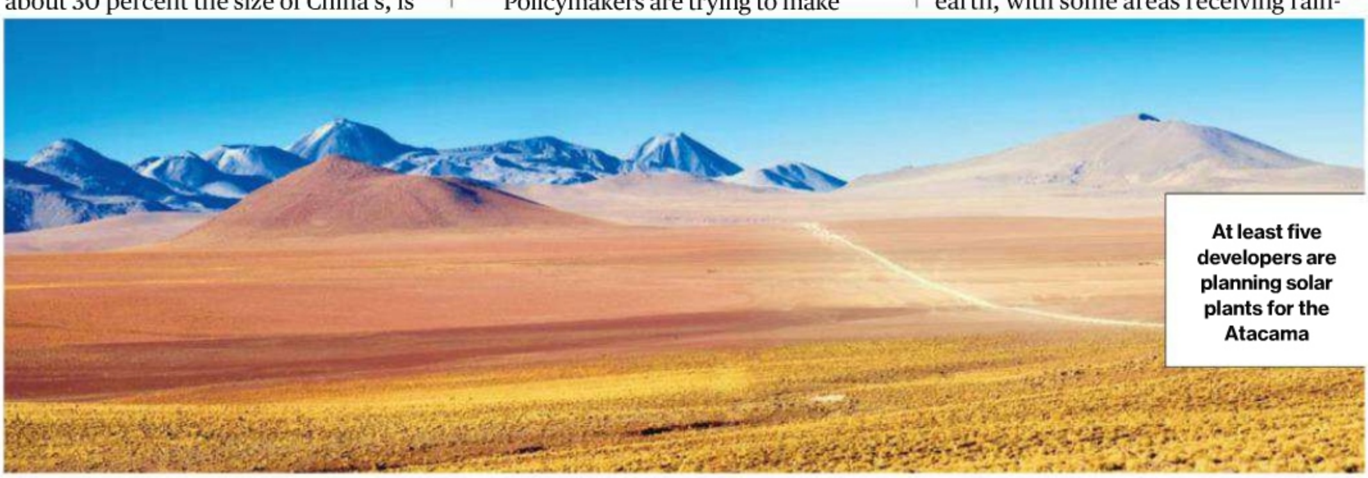
Renewable Energy

A Solar Mother Lode For Chile's Mines

▶ A desert in the north may be the best place on earth for solar power

▶ "We have an energy resource here that's absolutely unique"

The Atacama Desert in northern Chile has two claims to fame: It's where 33 miners were trapped underground for nearly 10 weeks last year, and it's one of the driest–and sunniest–places on earth, with some areas receiving rain-



At least five developers are planning solar plants for the Atacama

FROM TOP: DANIEL LYNCH/FINANCIAL TIMES-REA/REDUX; JOSE LUIS STEPHENS /RADIUS IMAGES/CORBIS

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In the eye of Egypt's hurricane page 17 ▶

fall just once a decade. The miners, of course, are part of the copper-rich region's biggest industry, and the sunshine explains why mining companies there are starting to use solar energy to power their operations.

More than a dozen solar installations are planned for the barren plateau in the Andes, which gets up to 9.28 kilowatt-hours of sun power per square meter each day, nearly double what Las Vegas receives. Solar companies say the strength of the sunshine means they can provide the region's dozen or so large mines and hundreds of smaller ones with electricity at prices rivaling energy from plants that burn fossil fuels. Atacama "has good sun resources and big, unfulfilled demand for power from mining companies," says Tim Keating, marketing chief at **Skyline Solar**, a California company that is in talks with several mines to provide photovoltaic equipment.

2.4
MILLIMETERS

Average annual rainfall at Yungay, the driest part of the Atacama

Developers see a strong market for their electricity among the Atacama's power-hungry mines, which typically require anywhere from 10 to 400 megawatts of power. More than 80 percent of the electricity used in northern Chile is sold to mining operations, and demand will likely grow at least 5 percent annually for the next several years, according to Santiago energy researcher Systep Ingeniería y Diseños.

Santiago-based **Atacama Solar** has applied for a permit to build a $773 million, 250-MW solar farm in the region by 2018. **Element Power** of Portland, Ore., is planning five 30-MW projects near mines in the Atacama. And Spanish energy developer **Solarpack Corp. Tecnologica** this year will open a 1-MW plant at a mine owned by Corporación Nacional del Cobre de Chile, the state-owned copper mining company known as Codelco.

Swiss mining giant **Xstrata** says it is studying solar installations for its mines in the Atacama. Codelco says that if the Solarpack project goes well, it expects to expand its use of solar power at mines in the region. "We have an energy resource here that's absolutely unique," says Silvia Tapia, who oversees renewable energy projects for Codelco. "It's where our operations are, so it's obvious we should use it."

Chilean utilities currently sell electricity on the spot market for about 12¢ a kilowatt-hour, though some mines have long-term contracts for 8¢ to 10¢ per kilowatt-hour, Systep estimates. Solarpack says its Codelco plant will be able to sell electricity for 10¢ to 14¢ per kilowatt-hour with no subsidies—which would make it the only large solar facility on earth to operate profitably without government support, according to Bloomberg New Energy Finance. Solarpack is planning two additional 9-MW solar generating stations nearby that it hopes to use to provide power to Codelco. The intense sunshine in the Atacama, says Jon Segovia, a director for Solarpack's Chilean unit, "means you can produce more electricity for the same investment." —*Stephan Nielsen*

The bottom line *With its abundant sunshine and power-hungry mines, Chile's Atacama Desert is seeing a boom in solar power development.*

Interest Rates

When Will China's Inflation Subside?

▶ **The central bank's latest rate hike probably isn't the last**

▶ **"There is still ... heavy lifting to do in terms of rates"**

China's central bank raised rates for the third time since mid-October—and its fight against inflation isn't over yet.

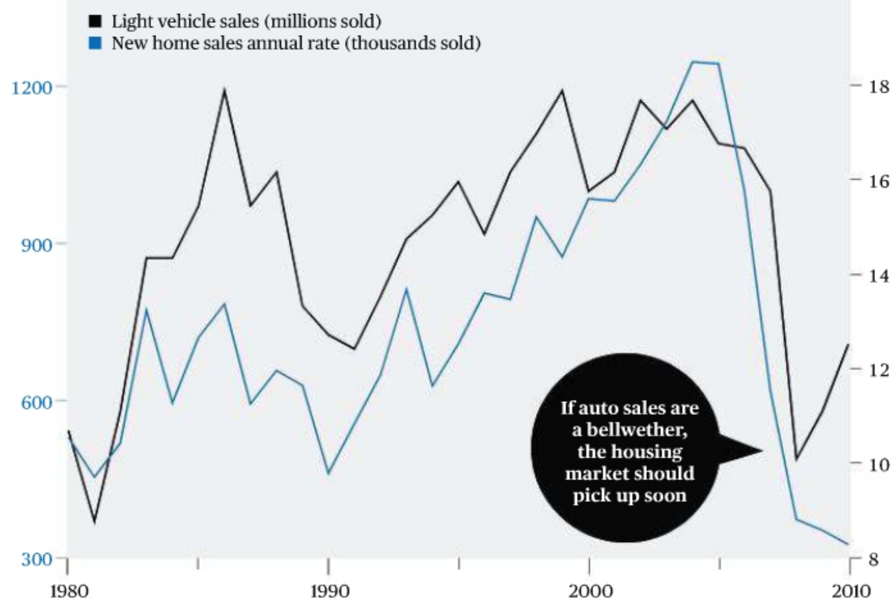
The People's Bank of China raised the one-year lending rate by a quarter-point on Feb. 8, to 6.06 percent. The one-year deposit rate went up an equivalent amount, to 3 percent. The PBOC moved before a report in mid-February that may show consumer prices rose 5.3 percent in January, according to the median estimate in a Bloomberg News survey of economists. "There is still a substantial amount of heavy lifting to do in terms

➔ 15

Consumer Demand

Let's Throw in a House with That Car

Rising demand for cars and trucks signals U.S. new-home sales may jump more than 30 percent this year, according to Bank of America Merrill Lynch. New-home sales have tracked sales of lightweight vehicles in the past 40 years, based on data from the U.S. Census Bureau and the Bureau of Economic Analysis. —*Prashant Gopal*



DATA: U.S. CENSUS BUREAU, BUREAU OF ECONOMIC ANALYSIS

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Tom Keene's EconoChat

Tom talks with senior economist **Drew Matus** of UBS Securities on changes in the American workforce

Drew, are we seeing a structural change in the workforce?
We did a piece recently suggesting that we are seeing a cyclical downturn in the labor force participation rate, but also a structural one for the baby boomers.

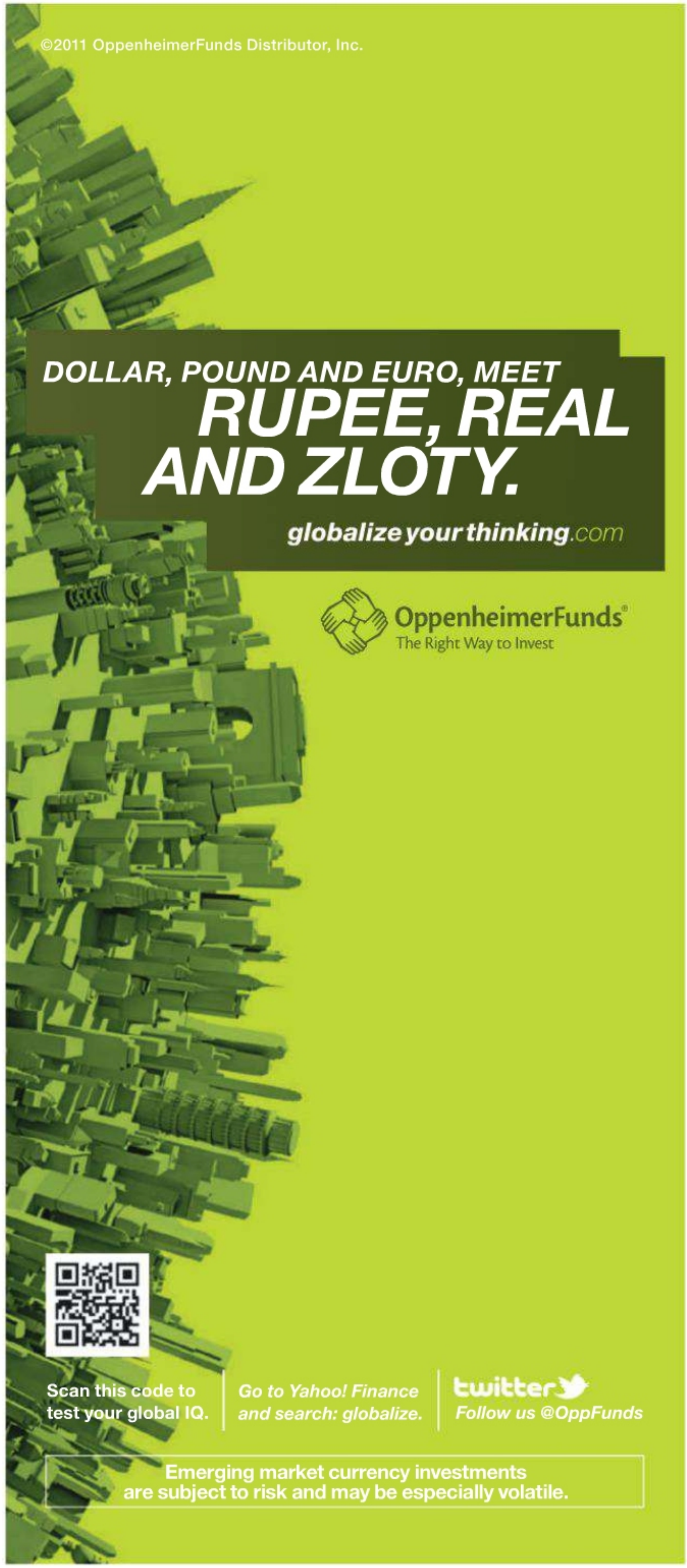
What's the structural change for boomers?
When people begin to get closer to retirement age, their attachment to the workforce becomes less. So, for example, if–and this isn't exactly the way it works–you are a 54-year-old male, your participation rate in the labor market is around 89 percent.

So 89 percent of these men are either working or looking.
But if you go to age 57 or 56, you are down to the forties. So if you swing that population of boomers from 89 to 40 percent, you can tell that their overall participation rate in the workforce goes down.

So what portion of the recent downturn in employment is cyclical and what portion structural?
I think it's about 50-50. Another interesting point is this perception that baby boomers have not saved enough for retirement and must keep working. The facts simply do not bear this out. The net worth of the generation approaching 65 is higher than the previous generation. What that tells me is, fine–life expectancy has increased a little and there is some desire to keep working more. But is there a need? I cannot find evidence of that.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*



WorldMags

of rates—at this stage of the cycle, the fact that we still have negative real rates is quite alarming," says Glenn Maguire, chief Asia economist at **Société Générale** in Hong Kong.

Premier Wen Jiabao's government has yet to return rates to their higher pre-crisis levels. Now, with overheating a danger in the first half of the year, policy makers are likely to raise their benchmark interest rates further, order banks to set aside more cash as reserves, and let the yuan appreciate to stem price pressures, Wang Qing, a Morgan Stanley economist in Hong Kong, wrote in a note on Feb. 7. Wen's government is selling state food reserves to lower food prices, providing more low-income housing, and cracking down on speculation and hoarding.

A drought that's threatening grain output and a New Year surge in lending are adding to inflation risks. Economic growth accelerated in the fourth quarter, to a 9.8 percent annual pace.

In the Feb. 8 move, the People's Bank raised long-term rates for deposits more than it did for loans. For savers, the increase was as much as 45 basis points for five-year deposits. "The goal is to encourage savers to keep their money in bank deposits rather than shifting to equities or property," says Mark Williams, a London-based economist at Capital Economics.

Companies from **Baoshan Iron & Steel** to **Starbucks** have raised prices. While wages are also climbing, Chinese consumers are more concerned about inflation than at any time in the past decade, according to a central bank survey released in December.

The government knows January's inflation number will "look ugly" and wants to be seen as acting in the lead-up to the annual meeting of the National People's Congress in early March, says Ma Jun, Deutsche Bank's chief China economist. China aims to hold inflation at 4 percent this year, state broadcaster CCTV reported in December. To get there, Isaac Meng, a Beijing-based economist for BNP Paribas, says he expects "accelerated tightening," with rates rising by as much as an additional 1.5 percentage points. ⓑ *—Li Yanping and Shamim Adam*

The bottom line *China is still fighting inflation after three interest rate hikes. Economists expect further rate hikes before inflation is subdued.*

FROM LEFT: ANDREW HARRER/BLOOMBERG; ILLUSTRATIONS BY JULIA ROTHMAN

Events of note in the week ahead

Seven Days

by Ira Boudway



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Valentine's Day

China's consumer price index



▶ **Mobile World Congress:** Speakers at the four-day industry gathering in Barcelona include AT&T's Randall Stephenson, Microsoft's Steve Ballmer, Google's Eric Schmidt, and Twitter creator Jack Dorsey.

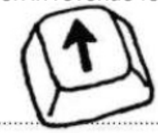
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Fourth-quarter GDP from France, Germany, and Italy

Tesla Motors earnings



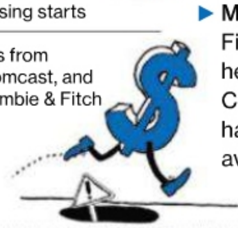
▶ **Dell earnings:** A boost in commercial sales helped the PC maker beat forecasts in the third quarter. Analysts expect $15.7 billion in revenue for the fourth quarter.



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U.S. housing starts

Earnings from CBS, Comcast, and Abercrombie & Fitch



▶ **Meltdown postmortem:** The House Financial Services Committee hears testimony from the Financial Crisis Inquiry Commission, which has concluded that the crisis was avoidable.

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Philadelphia Fed Business Outlook Survey

China and U.S. leading economic indexes



▶ **U.S. consumer prices:** Surveyed economists expect prices to rise by slightly less than the December increase, which was 0.5 percent.

18

London Fall Fashion Week begins

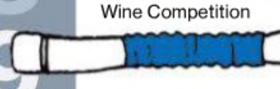


■ **Uganda Elections:** President Yoweri Museveni, in office since 1986, is expected to win a fourth term. Opposition leader Kizza Besigye says protests are likely if the elections are not fair.

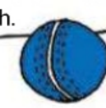


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San Francisco Chronicle Wine Competition



▶ **Cricket World Cup:** The top 14 national teams begin competition in the six-week tournament held in India, Sri Lanka, and Bangladesh.



20

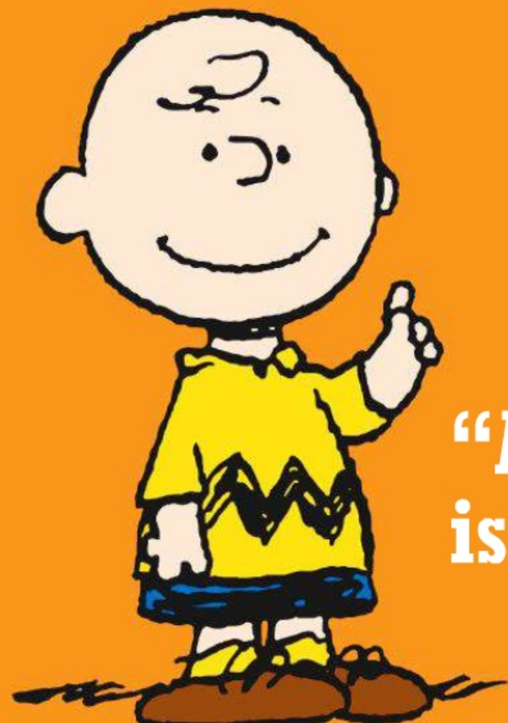
Japan's All Industry Activity Index

▶ **Daytona 500:** The Nascar season opens in Florida with its biggest and most lucrative race.



For more events and interactive content, visit Businessweek.com.

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– Charlie Brown

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Companies&Industries



Sawiris says an orderly regime change could be good for business

An Uprising— And an Opportunity

▶ **Orascom's Naguib Sawiris says business will continue to invest after a peaceful transfer of power**

▶ **"The fact that a family like mine did not leave is a good sign"**

Most Egyptian businessmen are keeping low profiles these days. The protesters in Cairo's Tahrir Square blame them for Egypt's ills, and mobs have even trashed some of their properties. Yet Egypt's most prominent mogul, Naguib Sawiris, chairman of **Orascom Telecom Holding**, the Middle East's biggest telecom company, is in Cairo fielding calls on his mobile phone, appearing on TV, and (as a member of an informal committee of "wise men") negotiating with newly appointed Vice-President Omar Suleiman about a gradual transfer of power away from President Hosni Mubarak. Far from discouraged, the billionaire thinks a more vibrant Egyptian economy may emerge from the turmoil. "We will pull out [of the current crisis], I promise you," he says. "The fact that a family like mine did not leave is a good sign."

Nile City Towers, where Orascom is headquartered, drew looters



Some Cairo protesters have spoken ill of Sawiris, and looters have vandalized the shops, including an **HSBC** branch, on the ground floor of his massive Nile City Towers complex. Yet he's been lucky so far. Unlike many Egyptian businessmen who rushed to serve in Mubarak's National Democratic Party or sought ties to the President's son, Gamal, the tart-tongued Sawiris isn't known publicly as a close ally of the regime. Before the crisis, he

FROM TOP: DANIEL LYNCH/FINANCIAL TIMES-REA/REDUX; SHAWN BALDWIN/BLOOMBERG

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Financial reform's cash crunch page 24 ▶

spoke openly about Egypt's ills and helped bankroll an independent newspaper, *Al-Masry al-Youm*. "He has maintained his distance from the ruling Establishment, not alienating them but not courting them," says Khaled Fahmy, a professor of history at the American University in Cairo.

Sawiris has over the past two decades built a mobile telecom business with 103 million subscribers and $3.1 billion in revenues for the first three quarters of 2010, and long invested in such fractious locales as Iraq, Algeria, and even North Korea. His telecom operation is currently in a jam, saddled with $15 billion in debt from previous acquisitions and expansions and locked in an expensive tax dispute with Algeria. In October, Sawiris reached a $6.5 billion agreement to merge much of his telecom holdings with Russian cellular operator **VimpelCom**. He says the sale, which does not include his Egyptian mobile holdings, is not affected by the turmoil in Egypt.

The Sawiris family, which includes two other brothers, Nassef and Samih, also controls the Mideast's largest publicly traded construction company and such resorts as El Gouna on the Red Sea coast. Naguib's children are staying there during the unrest.

Sawiris is optimistic about the post-Mubarak era. Investors, he says, should view a democratic Egypt as an opportunity. Better to do business relying on the rule of law rather than the whims of an autocratic government, he reasons. "Investment will go up," he says. "I am ready to put more money in."

Egypt's economic growth is almost certain to be slashed in the short run. The country's borrowing costs have risen and its reputation as a tourism destination has been damaged by TV images of mass demonstrations and chaos. Nonetheless, says Mustafa Abdel-Wadood, an Egyptian national who is a managing director of Dubai-based private equity firm **Abraaj Capital**, "the core thesis for Egypt still holds." The attractions: a large youthful populace with increasing spending power, and growing revenues from exports of natural resources, particularly oil and gas.

A regime change, if it occurs smoothly, will remove a key source of worry for global investors. Now, "in an ideal scenario, you have a more solid foundation for future growth," Abdel-Wadood says. Another scenario Sawiris says is possible: An Islamic regime comes to power and takes Egypt in an anti-democratic direction. "We need to prevent the kidnapping of the revolution by the fundamentalist movement, like an Iranian-style government," says Sawiris, a member of the Coptic Christian minority.

So far, Egypt remains open for business. Oil and gas production have not been disrupted and drilling, which was temporarily halted, is resuming, says Frank Chapman, chief executive officer of British energy company **BG Group**, which with partners has invested $10 billion in Egyptian gas projects. Whatever new government takes over "will want to see a continuation of the contribution companies like BG are making" to the economy, he says.

Even Egyptian businessmen, whose ostentatious wealth caused resentment in a nation where per capita income is about $2,500 a year, are now open to reform. Yasser El Mallawany, co-CEO of Cairo-based investment bank **EFG Hermes**, says the new government needs to "take from the rich to give to the poor" to support small and midsize enterprises that create jobs. Sawiris agrees more is needed to help spread prosperity. "We need a Marshall Plan here," he says. "If Egypt turns into an Iran, it is a disaster."

—*Stanley Reed, with Mahmoud Kassem*

The bottom line *Naguib Sawiris, chairman of the Middle East's largest telecom company, believes Egypt's turmoil may foster a better business climate.*

The Evolving Empire of Naguib Sawiris

Orascom Telecom's deals and disputes

VimpelCom merger

Sawiris's family holding company agreed last October to a

deal to merge Orascom's telecom businesses with Russia's VimpelCom. Sawiris's interests will get a 20 percent stake in VimpelCom and $1.5 billion in cash.

Tax troubles in Algeria

Algeria has levied additional tax on Orascom's local subsidiary for 2008 and 2009. That raised its bill by

Orascom has challenged the hike. It had earlier been hit with a big tax reassessment claim for 2005-2007.

Tunisia mobile unit sale

In January, Orascom sold its 50 percent stake in a Tunisia cellular business for

in cash to Qatar Telecom. The deal allows Orascom to pay down debt and redeploy capital into faster-growing businesses.

France Telecom deal in Egypt

Orascom in April 2010 settled a dispute with partner France Telecom over their joint ownership of a controlling stake in Mobinil, Egypt's largest mobile service operator, with 40 percent of the market. France Telecom paid Orascom

Pharmaceuticals

Sangamo's Bet Against AIDS: Gene Therapy

▶ **Inspired by one man's cure, the biotech tweaks patients' genes**

▶ **An AIDS pioneer hopes for "a long-term functional cure for the virus"**

Timothy Brown may be the only person cured of AIDS. Brown, who lives in San Francisco, in 2007 received a stem-cell transplant in Berlin that transferred genetic material to him from one of the up to 2 percent of humans with a natural immunity to the disease. He has been off treatment since then, and no traces of the AIDS virus have been found in his body, says his hematologist, Gero Hütter, now with the German Red Cross in Mannheim. His case has encouraged tiny **Sangamo BioSciences** to develop a new form of gene therapy that could offer others the same result.

While there's no guarantee Brown, 44, will remain virus-free, his case has spurred scientists to try to duplicate the result without a dangerous stem-cell transplant. Sangamo, a Richmond (Calif.) biotechnology company, will report data late this month on a gene therapy that's likely to be less risky. If the results are a success, and the method is eventually approved, it may generate $750 million a year in U.S. sales, says Liana Moussatos, a biotech analyst at Wedbush Securities. "It's high-risk, but definitely high-reward," she says. "If this is a cure for HIV that prevents or reduces the lifelong need for

FROM LEFT: SAUL LOEB/AFP/GETTY IMAGES; PHOTOGRAPH BY ALESSANDRA SANGUINETTI FOR BLOOMBERG BUSINESSWEEK

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drugs, that's a huge accomplishment."

Sangamo's stock has more than doubled since July 6, when the company, with no products on the market, reported success of its gene therapy approach in mice in the journal *Nature Biotechnology*. One reason for the enthusiasm: The therapy, using a new technology that acts like biological scissors to cut into genes at precise points, may also treat other diseases, such as hemophilia, Parkinson's, and neuropathy, the nerve damage caused by diabetes, says Sangamo Chief Executive Officer Edward Lanphier. An approved treatment for neuropathy alone, which has no cure, may generate $6 billion a year, Moussatos says.

Sangamo is conducting two studies of its HIV therapy in 21 people. Both are in the first stage of testing usually required to win U.S. regulatory approval. Its preliminary data will be reported on Feb. 27 at a medical conference in Boston. Moussatos says that if the data are strong, Sangamo may attract partnerships with larger drugmakers that it will need to help finance larger trials.

There are 1.1 million Americans living with the AIDS-causing HIV virus, and 34 million are infected worldwide, according to the U.S. Centers for Disease Control and Prevention. Antiviral drugs, led by Atripla and Truvada, made by **Gilead Sciences** and **Bristol-Myers Squibb**'s Reyataz, generated $15.1 billion in worldwide sales last year, according to industry researcher **IMS Health**.

Brown was cured of AIDS after a stem-cell transplant. Sangamo hopes to duplicate the result with a less-risky technique

AIDS first emerged in 1981 and, in the early years, killed most of those infected within a year of diagnosis. In 1996 doctors began combining three different families of drugs to overcome HIV's ability to become resistant. That extended lives of patients in North America and Europe by at least 13 years on average, according to a 2008 study. Still, the drugs aren't a cure, since the virus rebounds when their use stops. They are taken daily, often cause nausea, and can trigger kidney damage. They also need to be regularly adjusted as the virus mutates, gaining resistance in the body.

In the Sangamo process, doctors draw patients' blood and remove infection-fighting white blood cells. They are then modified using naturally occurring proteins called zinc fingers that cut into patients' DNA at selected points. Chopping the DNA in the middle of a gene called CCR5 eliminates a receptor that HIV uses to gain entry to cells. The modified cells are then returned to the patient through an infusion.

"This approach shows the most promise of any that I know of," says Jay A. Levy, a researcher at the University of California in San Francisco who helped identify HIV as the source of AIDS in 1984. "It's a terrific way of looking for a long-term functional cure for the virus."

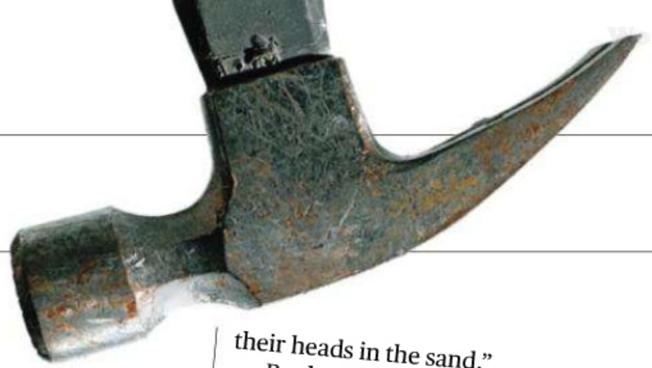
One person who hopes it will prove effective is Matt Sharp, 54, an AIDS educator who was diagnosed in 1988 and today takes a daily regimen of three antivirals. He learned about the Sangamo trial a year ago and enrolled. Since last summer, when Sharp received an infusion of his own gene-modified T-cells, blood cells that help the immune system fight infection, the number of those cells has doubled, he says. "I'm just hoping I could get an infusion once a year that would keep HIV under control and I won't have to deal with the effects of taking medication."

CCR5 isn't a new target. The gene pathway was first noticed in the mid-1990s by scientists studying people immune to HIV infection. In these people, including the donor who contributed stem cells to Brown, the CCR5 gene is mutated and inactive, keeping the virus from gaining a foothold in the immune system. For most HIV patients, however, a stem-cell transplant is impractical and risky. It requires finding a donor with the CCR5 mutation and whose tissues and blood match the patient's–and carries about a 30 percent risk of death, says Levy.

That's too high a risk for most AIDS patients who have access to proven antiviral medicines. Brown, previously known in medical circles only as "the Berlin patient," was willing to take the chance because he also had developed a potentially fatal case of leukemia–a blood cancer that can also be treated by stem-cell transplants. When chemotherapy stopped controlling his leukemia, Brown and his doctors

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decided to find a donor with genetic characteristics that would allow treatment of both conditions simultaneously. Brown underwent two stem-cell transplants. Afterward he developed neurological problems and other side effects and spent a year in the hospital, at some points near death. He eventually recovered and was released in early 2009.

"If I hadn't survived, I kind of doubt that the work towards a cure would have gone this far," Brown says. Now he hopes scientists will be able to develop new therapies based on his treatment "so people can be cured of HIV without having to go through what I went through." *—Rob Waters*

The bottom line *Sangamo BioSciences is testing a gene therapy for AIDS inspired by a cured patient. The first results come this month.*

Housing

The Repair Bills Arrive From the Housing Boom

▶ Homebuilders rushed projects in the boom. Some are now crumbling

▶ "Their liabilities are underfunded. They have their heads in the sand"

Seattle city planner Alan Justad is reviewing a project that will bring back the cranes, dust, and noise absent since the real estate bust. Yet this one will subtract from the local skyline rather than add to it. The owners of McGuire Apartments opted to tear down the 10-year-old glass-clad building in the upscale Belltown neighborhood after discovering that steel support cables encased in its concrete structure had corroded. The repair bill would have been $60 million—almost double the project's construction cost. "We've never had anything like this happen before," says Justad, who expects demolition of the 25-story tower to begin later this year.

The U.S. construction boom between 2000 and 2005 added more than 10 million apartments, condominiums, and single-family homes to the nation's housing stock. Although that building frenzy is long gone, it's still generating a repair bill for construction flaws that may hamper the industry's recovery. Homes with cracked foundations and sagging ceilings will only add to the supply of hard-to-sell properties, says Jack McCabe, chief executive officer of McCabe Research & Consulting, which tracks real estate. "A lot of construction flaws slipped through the cracks," he said. "We're just on the cusp of it now."

The rush to meet demand fueled by low interest rates and liberal lending resulted in a doubling of defects per newly constructed housing unit from 2000 through 2005, compared with the previous six-year period, according to International Association of Certified Home Inspectors estimates. Add to that the billions of dollars in repair costs and damages at stake in ongoing litigation over allegedly dangerous Chinese drywall imports, and builders are facing a skyscraper-sized liability headache. "Homebuilders don't want to draw attention to it, but they've got creeping costs for construction defects," says Vicki Bryan, an analyst at Gimme Credit in New York.

PulteGroup, the largest U.S. homebuilder, recorded a one-time expense of $272.2 million in the third quarter, or 25 percent of its revenue for the period, to increase reserves to cover losses when homeowners demand repairs to houses built in the past 10 years. Chief Financial Officer Roger A. Cregg told analysts on Nov. 3 there was a "greater frequency of newly reported claims" by people with company-provided warranties. Pulte spokesman Jim Zeumer says, "We were building significantly more houses during that period, so part of this may just be the math of more homes."



Claims can take time to surface because home warranties typically span a decade—which is also the amount of time many states allow for filing lawsuits for alleged defects.

That could mean some builders will need to set aside more money for repairs and legal claims in years to come, says Ron Kozlowski, a Hong Kong-based senior actuary at **Towers Watson**, a consultant to insurers. "Their liabilities are underfunded," he says, declining to identify specific builders. "They have their heads in the sand."

Replacing faulty Chinese drywall in U.S. homes may cost more than $15 billion alone, Kozlowski estimates. He said he has reviewed claims for other construction failings totaling $15 billion to $20 billion, including the kind of water intrusion that doomed the Seattle apartment building. "The whole construction defect issue is multiples" of the drywall amount, Kozlowski says.

D.R. Horton, the second-largest homebuilder, puts its net liabilities for construction defects and other claims at $319.8 million on Sept. 30, more than double the $137.2 million on Sept. 30, 2003. The increase was due to the number of homes built, not any decline in quality, says D.R. Horton spokeswoman Jessica Hansen.

Homebuilders and subcontractors are finding it more difficult than five years ago to tap insurance to cover payments to homeowners because insurers have added so many exceptions, says Dave Stern, vice-president at **West Coast Casualty Service**, an insurance adjuster in Westlake Village, Calif. In California, "basically, the thing leaks, it's the builder that's liable," Stern says.

At Pulte, most of the claims in the third quarter were related to water intrusion, CEO Richard J. Dugas Jr. told analysts on Nov. 3. "That was completely unforeseen," he said. Given the 10-year warranty periods, it's a "tough science to nail down" when people will decide to ask for defects to be fixed, he said.

One reason for snowballing warranty claims: In the rush to make deals, buyers often didn't ask for inspections, which some mortgage companies didn't require, says Bruce Barker, an inspector in Phoenix for more than a decade. Natalie Crump didn't have her house inspected before moving into Hutto Parke, built in an old cotton field a 30-minute drive from Austin, Tex. She bought a three-bedroom home there with her husband Mike for $136,490 in 2006. Since then, the Crumps and owners of 12 other houses have filed lawsuits against builder **Lennar**, claiming foundations are fracturing and fences sagging because the homes went up on unstable soil, according to

THIS PAGE: RYAN MCVAY/GETTY IMAGES (2); OPPOSITE PAGE: PHOTOGRAPHS BY CLAIRE BENOIST FOR BLOOMBERG BUSINESSWEEK

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their lawyer, Kyle Pugh of Dallas.

A year after they moved in, the Crumps spotted bubbles in the ceiling of their daughter's room that turned out to be nails sliding out of sheetrock, she says. Lennar officials told them it was because workers hammered the nails incorrectly, she says. Then the driveway sprouted a crack more than six feet long, she says, while ceilings inside bowed. Lennar offered to make repairs, she says. She and her husband sued instead. "Who wants a brand-new repaired house?" says Crump, a horse trainer.

A Lennar spokesman, Marshall Ames, said the "nail pops" the Crumps saw are common in homebuilding. The company offered to make sheetrock repairs to the 443 houses in the subdivision and 221 homeowners accepted, he said in an e-mail, adding that accusations in the lawsuits are unfounded. "Our homes have been built to the same consistent quality standards for years," and the construction boom didn't change that, he said. *—Peter Robison and Kathleen M. Howley*

The bottom line *Poor construction work during the housing boom has left U.S. builders facing billions of dollars in possible liabilities and damages.*

Toys

Why Ken Is the New Babe-Magnet in Toyland

▶ **Barbie's "arm candy" is finally getting some attention of his own**

▶ **"They softened his looks a bit, but he's still as handsome as ever"**

Barbie Millicent Roberts has fallen for Ken Carson. Again. The world's most famous plastic couple is scheduled to reunite on Valentine's Day. The comeback will be no small feat for Ken, who sank into obscurity after Barbie dumped him in 2004, ending a relationship that had endured 43 years. The split, described then in a **Mattel** press release as the "breakup of the millennium," cast Ken further into Barbie's 11½-inch shadow.

The rejection came as no surprise to Ken fans. Over the decades they'd watched him become little more than an accessory, like one of Barbie's sparkly tiaras. Mattel even referred to him as "arm candy." Then in 2004, Ken disappeared altogether. "He's never been in the spotlight," says Jef Beck of Cedar Rapids, Iowa, founder of He's a Doll!—a Ken collectors club—and the author of the forthcoming *I ♥ Ken: My Life as the Ultimate Boyfriend*.

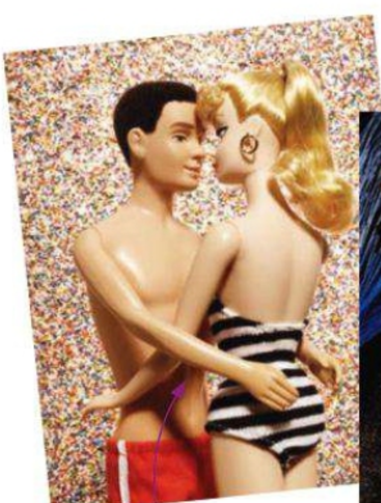
Much as *Pulp Fiction* did for John Travolta, Ken's scene-stealing part in *Toy Story 3* restored him to his previous status of pop culture icon. The **Walt Disney-Pixar** film was 2010's highest-grossing film worldwide, with $1.06 billion, and earned a Best Picture Oscar nomination. Mattel's publicity machine has been in overdrive ever since. Ken, who turns 50 on Mar. 13, now has his own Facebook page and Twitter feed (sample tweet: "Weekend Ken-fession: I may have knocked somebody over while walking and playing Madden on my iPhone this morning. My bad."). In January, Hulu.com began airing a Bachelor-style reality show called *Genuine Ken: The Search for the Great American Boyfriend*.

Beaming with confidence after his big-screen debut, Ken won his ex back with professions of love on big-city billboards and ads in *Us Weekly*. One message: "We may be plastic, but our love is real."

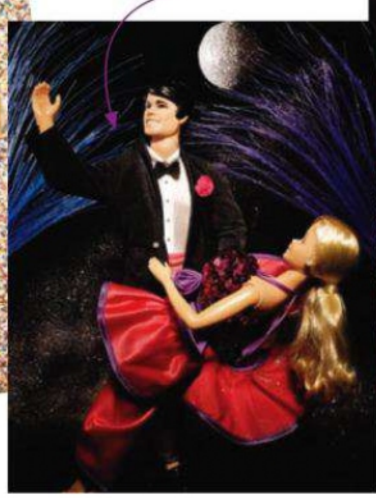
His handlers also revamped his image, giving Ken a Justin

A (Plastic) Love Story

Barbie and Ken through the ages



1961
Ken Carson and Barbie Millicent Roberts fall for each other while filming a commercial



1984
The relationship peaks as Barbie can't get enough of "Great Shape Ken" and "Sun Gold Malibu Ken"

$6.6 bn
Brand's sales since 2006 (est.)



2004
After 43 years together, Barbie devastates Ken by dumping him for Blaine, an Aussie surfer

33,000
Facebook Page "Likes" for Ken



2011
The *Toy Story 3* star uses his newfound fame to win back his girl

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Companies&Industries

Bieberesque makeover complete with floppy locks, skinny jeans, and graphic T-shirt. "They softened his looks a little bit, but he's still as handsome as ever," says Sandi Holder, a Barbie expert from Union City, Calif., who once auctioned one of the dolls for a Guinness World Record of $27,000.

Ken's comeback has been years in the making and came after a shakeup at the world's largest toy brand—Barbie sells more than $1 billion a year—that began in 2008 when Richard Dickson took the reins of a business in decline. Amid competition from upstart brands such as **MGA Entertainment**'s Bratz dolls, the Barbie division had lost about a quarter of its revenue since 2002. "Many people said, 'Are you sure you want to get into that mess?'" says Dickson, who had previously run Mattel's consumer products unit.

The new guardian of Toyland's First Couple was less protective of the brand's image than the previous regime. "We gave people permission to play with our brand, to have fun," in the hope that it would become culturally relevant again, says the 42-year-old Dickson, who left Mattel a year ago to become brand president at **The Jones Group**. Under his watch, Mattel greenlighted the couple's appearance in *Toy Story 3*. Mattel didn't have script approval and let the filmmakers cast Ken, voiced by Michael Keaton, as a vain, leopard-print-wearing metrosexual. In one scene, Ken cries: "I'm not a girl's toy." Says Dickson: "Poking at Ken's cultural noise is part of the fun. If you are talking about it ... then we are doing our job."

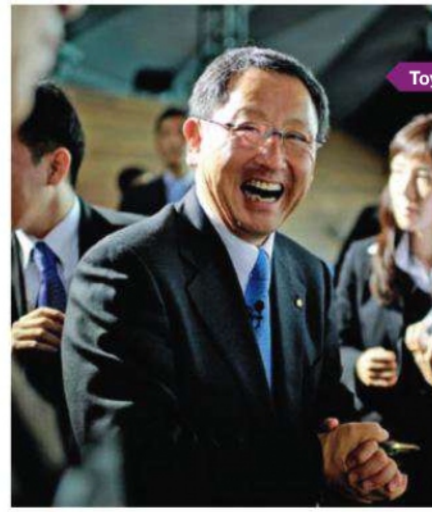
The changes Dickson unleashed have boosted the brand's sales, which rose 6.8 percent to $1.25 billion in 2010 and may increase 4 percent this year, according to UBS Securities analyst Robert Carroll. "Barbie has gotten her groove back," he says. Sales of Ken dolls have rallied too, says Stephanie Cota, who succeeded Dickson as Barbie chief, though she won't give specific figures. Despite Ken's breakout movie role and his growing ranks of Twitter followers, his future depends, as always, on the woman he loves. Says Cota: He'll stay in the spotlight "unless he does something to really upset Barbie." Ⓑ —*Matt Townsend*

The bottom line *Mattel has brokered a reconciliation between Ken and Barbie as part of its brand-marketing strategy.*

Briefs

by Caroline Winter

Toyota
Absolved, in part



Toyota Motor CEO Akio Toyoda got some overdue good news on Feb. 8. The National Highway Traffic Safety Administration and NASA in a joint report said they had found no link between electronics in the company's vehicles and sudden acceleration incidents. The investigation uncovered only mechanical problems. The recall of 8 million autos contributed to a 0.4 percent drop in Toyota's U.S. sales last year—even as industrywide deliveries grew 11 percent—as well as at least 400 lawsuits and record federal fines. Toyota says net income in the year ending Mar. 31 may more than double. The company's stock hit a 10-month high of $44.56 on Feb. 9.

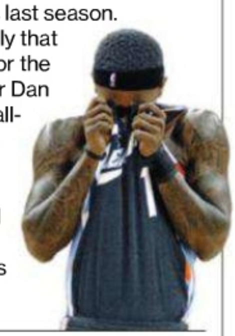
Central Japan Railway
Investing in speed



Central Japan Railway is staking $62 billion on building the world's fastest train. Slated for completion in 2027, JR Central's magnetic-levitation train will zip between Tokyo and Nagoya at 311 miles per hour, halving travel time on the 180-mile route to about 40 minutes. JR Central, which had free cash flow of $2.9 billion for the 12 months ended in December, will fund the project with cash, loans, and bonds. Last fiscal year, the company's bullet trains carried 138 million passengers—more than the world's largest airline, United Continental.

Cleveland Cavaliers
In free fall without LeBron

The Cavaliers set an NBA record with their 25th consecutive loss on Feb. 7. The streak highlights the impact of two-time MVP LeBron James's departure. The Cavs won a league-high 61 games last season. James announced in July that he was leaving to play for the Miami Heat. Cavs owner Dan Gilbert responded by calling James "cowardly." Gilbert told *Bloomberg Businessweek* in October that the Cavs would be "much, much better than most of the pundits are saying."



Royal Bank of Scotland
Shrinking its bonus pool

$1.5 BILLION

State-owned Royal Bank of Scotland cut the bonus pool at its investment banking unit by 27 percent to less than $1.5 billion. The decision follows a Feb. 9 announcement by Chancellor of the Exchequer George Osborne that the U.K.'s largest banks agreed to pay lower bonuses and set targets for business lending. The deal, known as Project Merlin, came a day after the U.K. raised taxes on the banking industry by $1.3 billion. Both RBS and Lloyds Banking said cash bonuses for 2010 will be limited to a maximum of $3,200.

Live Nation
On the prowl for acquisitions



Concert promotor Live Nation Entertainment is looking at possible acquisitions with John Malone's Liberty Media, its largest shareholder. Ties between the companies are strengthening, following Liberty Media's Feb. 7 agreement to raise its stake in Live Nation to over 20 percent, from 18 percent. Live Nation Chairman Irving Azoff pointed to home-shopping channel QVC, Sirius XM Radio, and premium cable channel Starz as possible targets. He says Liberty Media's investment lends Live Nation "stability in a very volatile business."

On the Move

Wells Fargo Timothy Sloan appointed CFO ● Deutsche Bank Eric Smith to be CFO of the Americas ● American Apparel John J. Luttrell named executive vice-president and CFO

CLOCKWISE FROM TOP: FRANCK ROBICHON/EPA/CORBIS; JASON POHUSKI/CSM/LANDOV; ROC CANALS PHOTOGRAPHY/GETTY IMAGES; TOMOHIRO OHSUMI/BLOOMBERG

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Politics&Policy

The Great Regulatory Holdup

▶ **The CFTC may lay off workers because of a cash crunch**

▶ **"It wouldn't be all that inappropriate to hit the pause button"**

When Congress overhauled the financial regulation system last year, it handed the U.S. Commodity Futures Trading Commission the tough task of policing the bulk of the derivatives business. Then lawmakers refused to give the tiny agency extra money to hire staff or upgrade its computer systems. The CFTC has been limping along on the same $169 million budget it had before its portfolio ballooned to include nearly $300 trillion in U.S. derivatives trades. It's a little like arming a big-game hunter with a pea shooter.

Six months after the Dodd-Frank law was enacted, the CFTC is struggling under the weight of its expanded duties. The agency has missed several deadlines as it tries to craft dozens of rules to make the derivatives market more transparent. It has restricted staff travel and cut $11 million from its technology budget. On Feb. 4, Chairman Gary Gensler had to address derivatives lawyers in Naples, Fla., by videoconference.

The agency recently warned Congress it may be forced to lay off at least 35 from a staff of about 700 next month unless it gets an emergency infusion of $31 million, according to two people familiar with the commission's budget problems. Even that small boost may never materialize, with Republican lawmakers and President Barack Obama girding for battle over how much to slice from the fiscal 2012 budget, which the President will release on Feb. 14. Representative Barney Frank (D-Mass.), a co-author of the financial overhaul, says the budget standoff could gut much of the law. "Let me be clear," says Frank. "This is a serious, serious threat."

The Securities and Exchange Commission is better off, though not by much. It's operating on a $1.1 billion budget, frozen at the 2010 level. Unable to afford new employees, SEC Chairman Mary Schapiro halted the creation of five offices required by the law, including units to supervise credit-rating firms, encourage whistle-blowers, and oversee municipal bonds. In a Feb. 4 speech, she said the funding problems were impeding the SEC's "core mission" of enforcing securities laws. The head of the SEC division that reviews company disclosures, Meredith Cross, says she's been unable to replace workers who have left and now looks out on 20 empty desks she hoped to fill. The SEC enforcement chief, Robert Khuzami, says he told his attorneys to interview witnesses by videoconference because of budget constraints. He says the agency can't afford technology upgrades to process the electronic tips and other evidence it receives.

Regulators are trying to balance congressional deadlines with writing sensible, practical rules, says Neal Wolin, deputy Treasury secretary. "There has not been any compromise thus far on getting it done right," he says. Frank sees the hand of Wall Street at work. "There is no question," he says, that Republicans are aiming their scalpels

The Rocky Road to Reform

Six months after President Barack Obama signed the Dodd-Frank financial reform bill into law, the U.S. Commodity Futures Trading Commission, the Securities and Exchange Commission, and other regulators are behind schedule or running into heavy traffic as they attempt to write the rules needed to put the measure into effect

THE RULE

DERIVATIVES
- Trade Derivatives on Exchange-Like Venues
- Disclose Derivatives Prices
- Reduce the Risk From Derivatives
- Reduce Banks' Dominance of the Derivatives Market

WALL STREET CURBS
- Tame Executive Pay
- Ban Proprietary Trading
- End Too-Big-to-Fail
- Limit Commodity Speculation
- Police Credit-Rating Agencies
- Encourage Whistle-blowers

MORTGAGES
- Reduce Mortgage Paperwork
- Clean Up Shoddy Mortgages

CONSUMER FINANCE
- Lower Debit-Card Fees
- Make Brokers More Accountable

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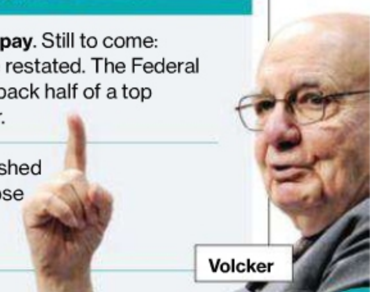
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By Robert Schmidt



THE GRADE	THE STATE OF PLAY
U-TURN	To make derivatives trading more like a stock exchange, the CFTC wanted traders to **post prices for everyone to see**. After big banks and Republican commissioners complained, the CFTC proposed that traders could request price quotes from just five dealers, making it easier for Wall Street to keep prices opaque and profits high. A final rule is due in July.
DANGER AHEAD	A CFTC proposal to **report prices of over-the-counter derivatives trades in real time** has drawn criticism from banks that say revealing the information too quickly would drive up costs and disclose clients' investing strategies. A final rule is due in July.
DANGER AHEAD	The CFTC and other agencies are determining how much money buyers and sellers of derivatives **must set aside in case of a default**. Corporations, which use derivatives to control costs, say putting up a lot of cash will needlessly tie up money. There is no proposal yet; a final rule is due in July.
DANGER AHEAD	A CFTC rule to **cap big banks' ownership of derivatives clearinghouses**, due in January, was delayed after large banks and Republican commissioners pushed back.
GREEN LIGHT, FULL SPEED AHEAD	The SEC on Jan. 25 approved giving shareholders **a nonbinding vote on executive pay**. Still to come: rules on how companies must recover all or some bonus payments if accounts are restated. The Federal Deposit Insurance Corp. on Feb. 7 proposed requiring large financial firms to hold back half of a top executive's bonus for at least three years—and to reduce the bonus if losses occur.
DANGER AHEAD	The law's **ban on trading by commercial banks for their own accounts,** a reform pushed by former Fed Chairman Paul Volcker, has already spurred many large banks to close "prop-trading" desks. A council of regulators last month called for "robust" enforcement, without revealing what that would be. A final plan is due in October.
DANGER AHEAD	Regulators must decide which banks, insurers, hedge funds, or private equity firms should be named "systemically important"—alongside the biggest banks—**and get special Fed scrutiny**. Many firms are resisting being named. Decisions may come by summer.
DANGER AHEAD	The CFTC on Jan. 13 **proposed limits on traders' stakes in oil, natural gas, gold, and other commodities**. A lack of economic data, dissension among the commissioners, and flak from GOP lawmakers could stall a final proposal, already overdue.
STOP	The SEC is charged with setting up an office to **watch over the credit-rating firms,** whose overly optimistic assessments of mortgage-related bonds helped trigger the economic crisis. The agency says it will be delayed "due to budget uncertainty."
GREEN LIGHT, FULL SPEED AHEAD	The SEC proposed giving corporate tipsters up to **30 percent of penalties the agency collects**. Companies fighting the rule say it undermines their internal compliance programs and are threatening to offer higher payments to keep the complaints in-house. A final rule is due in April.
GREEN LIGHT, FULL SPEED AHEAD	The new Consumer Financial Protection Bureau, still being set up, will propose a new mortgage disclosure form by July 2012. The agency wants to **eliminate 80 percent of the paperwork now required to buy a house**.
DANGER AHEAD	Six agencies are coordinating a plan to improve lending standards by **requiring banks to keep a 5 percent stake in the mortgages they sell to investors**. Most banks want to exempt a broad array of home loans, arguing the cost of mortgages otherwise would increase. A proposal is due in April.
DANGER AHEAD	The Fed has proposed **capping at 12¢ the fees merchants pay banks for accepting debit cards.** Banks say that could cost them $12 billion in revenue and are lobbying Congress and the Fed to change or delay the rule. It must be completed in April and is to take effect in July.
DANGER AHEAD	The SEC is considering forcing brokers to **put their clients' interests first**, as investment advisers must do now. Republican SEC members and the insurance industry, which employs brokers to sell annuities, may oppose the rule.





Volcker





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at the CFTC and the SEC to slow the derivatives rules that would harm bank profits more than any other new regulation. **Goldman Sachs**, **JPMorgan Chase**, **Morgan Stanley**, **Bank of America**, and **Citigroup** earned a combined $28 billion on derivatives trades in 2009, the year before the law passed, according to market sources and Federal Reserve data. Those profits are likely to decline as the complex securities are traded more in the open as required by the new law.

Republicans deny they are trying to help the banks. "It wouldn't be all that inappropriate to hit the pause button or extend some of those regulatory deadlines or requirements until we get our arms around where we're headed," says Randy Neugebauer (R-Tex.), who sits on the House Financial Services Committee.

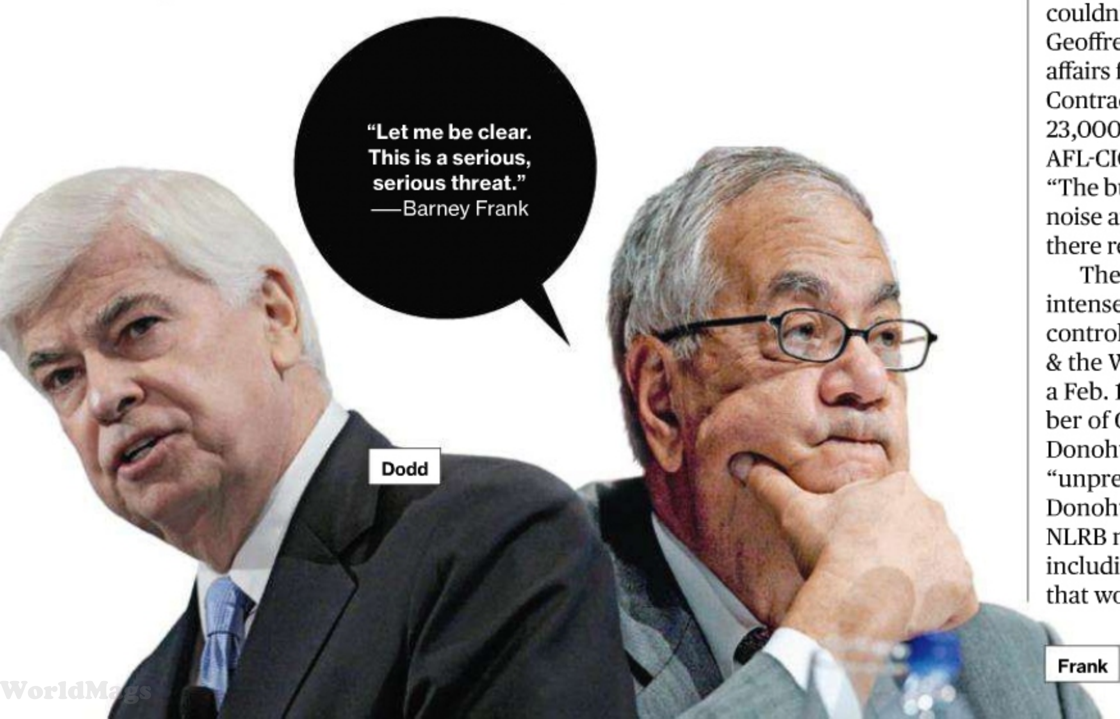
Even without budget politics, the agencies would have had a tough time following the Dodd-Frank law's timetable. The act requires 243 new rules, 67 one-time studies, and 22 recurring reports. Most of the work is supposed to be completed in July, one year after the President signed the measure.

There have been some notable successes. The new Consumer Financial Protection Bureau, still operating within the Treasury Dept., has hired 150 employees and is beginning to focus on two priorities: making credit cards and mortgages more consumer-friendly. Its interim leader, Presidential adviser Elizabeth Warren, has set a goal of creating new loan forms that will eliminate 80 percent of the paperwork involved in buying a home.

Across the bureaucracy, most of the rules that are on track are at the earliest and least controversial proposal stage and could still encounter snags. Others are already provoking fierce opposition. Banks are fighting a Federal Reserve proposal to cap the debit-card fees retail merchants pay to banks that issue the cards. Some analysts have estimated the rule could drain $12 billion in revenue from banks. Camden Fine, head of a trade group for community banks, says he is usually fighting the large banks, but in this case they have banded together to stop the rule. "This has united the entire industry," he says.

While Wall Street firms and their trade associations say they're not asking Republicans to cut agency budgets, there's no denying they want to slow-walk the process. Timothy Ryan, president of the Securities Industry and Financial Markets Assn., cautioned Treasury Secretary Timothy Geithner in a letter earlier this month that the rulemaking pace could disrupt markets. "In the balance between strict adherence to deadlines and creating regulations that work to the benefit of the broader economy," Ryan wrote, "I come down on the side of doing it right, rather than doing it fast." Doing it fast may no longer be a worry. *—Robert Schmidt with Phil Mattingly, Jesse Hamilton, and Silla Brush*

***The bottom line** Instead of unleashing a regulatory tsunami, financial agencies are slowing the creation of new rules and warning of layoffs as funds run out.*



Labor

A Backlash Looms for The Federal Labor Board

▶ Business lobbyists say the agency is rapidly overturning case law

▶ "They want to put as much teeth into it as they can now"

In the 1950s about one-third of American workers carried a union card. Today barely 12 percent do. In the private sector the rate is 6.9 percent and falling. The U.S. labor movement for years sought to arrest the decline with legislation allowing workers to organize once a majority of employees signed a card authorizing a union. Companies successfully fought so-called card-check measures, arguing that bypassing secret ballots was un-American.



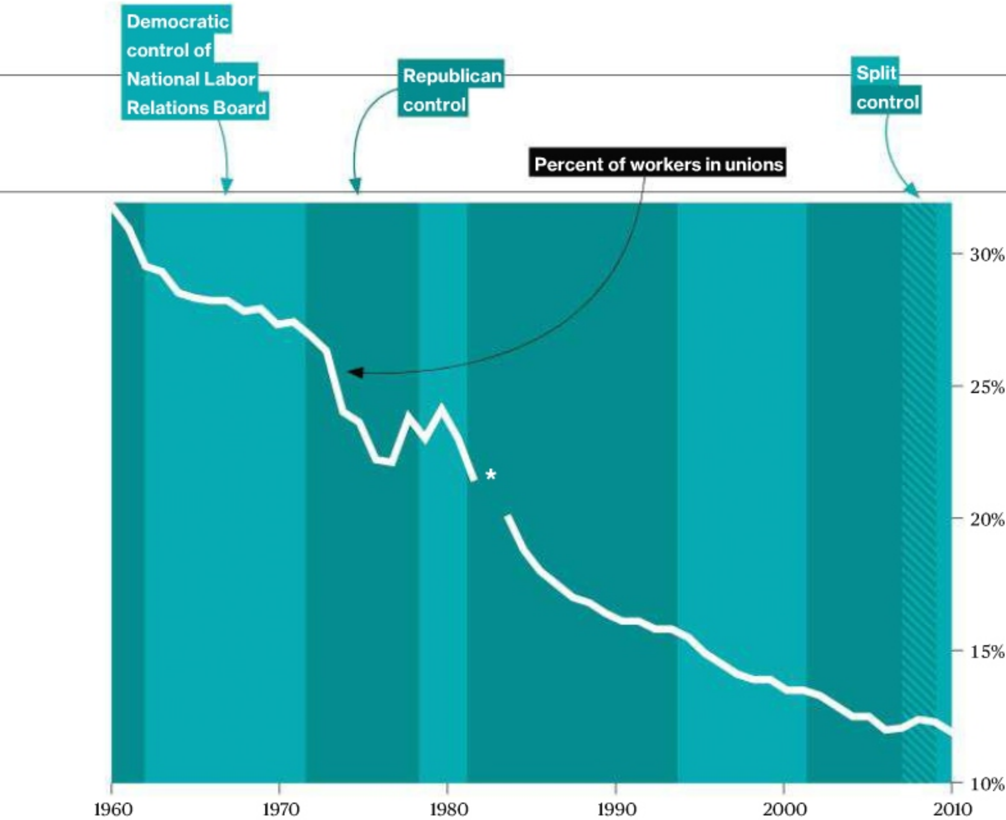
Republicans could block the renomination of the NLRB's Becker

These days unions are pinning their hopes on the National Labor Relations Board, one of Washington's more obscure federal agencies—and among the most politicized. Under President Barack Obama, the board has become a pro-labor bastion, turning out recent rulings that have angered the business community. "They couldn't be more antibusiness," says Geoffrey Burr, vice-president of federal affairs for the Associated Builders and Contractors, which represents more than 23,000 companies. Lynn Rhinehart, the AFL-CIO's general counsel, disagrees. "The business community is making noise and trying to create an issue where there really isn't one," she says.

The NLRB is about to come under intense scrutiny from the Republican-controlled House. The House Education & the Workforce Committee planned a Feb. 11 hearing on what U.S. Chamber of Commerce President Thomas J. Donohue, in a January speech, called "unprecedented" case law changes. Donohue was referring to a series of NLRB moves over the last six months, including a rule it floated in December that would require companies, for the

BLOOMBERG (3); GETTY IMAGES (1)

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Why Party Control Matters
Since 1960 union membership has declined at an average rate of 2.3 percent a year when Republicans controlled the National Labor Relations Board, faster than the average annual slippage of 1.5 percent under Democratic control. *Data for 1982 unavailable

DATA NLRB, CONGRESSIONAL RESEARCH SERVICE, UNIONSTATS.COM. *DATA FOR 1982 UNAVAILABLE BECAUSE THAT YEAR'S POPULATION SURVEY EXCLUDED UNION QUESTIONS.

first time, to inform employees of their right to unionize.

In September the board said unions could display banners outside the offices of a company's suppliers and customers. That decision allowed an Arizona carpenters union to display 16-foot banners reading "shame" to protest construction work being done for what the union claimed was substandard wages. In October the NLRB told **American Medical Response of Connecticut**, which provides private ambulance service, that it couldn't fire an employee for criticizing the company in Facebook posts from her home computer. On Feb. 7 the company settled the case—the first by the agency to assert that employers break the law when disciplining workers for comments on social media sites—and agreed to change its rules. The NLRB spokeswoman, Nancy Cleeland, declined to comment.

Created in 1935 to police relations between unions and management, the board helped the labor movement overcome vehement and sometimes violent management resistance. The Supreme Court upheld the board's landmark 1940 ruling that mining company Phelps Dodge could not discriminate against job applicants because they were union supporters, a ruling that stands today.

Over the past few decades, "the NLRB has become more politicized," says Charles I. Cohen, who served on the board during the Clinton Administration and is now at law firm Morgan, Lewis & Bockius. Favorable NLRB rulings have swung between labor and management—depending on who's in the White House. In 2007, under President George W. Bush, union members marched outside the Marble Palace (as its ornate headquarters is called) with signs saying "Shut the NLRB Down!" Their beef: The board had allowed employers to restrict the rights of temporary workers and graduate students to form unions. That year the NLRB also let dissenting workers undo a successful card-check campaign at auto parts maker **Dana Holding**.

Now, under Obama, business groups are braced for a card-check-like ruling that would skirt Congress and make it easier for workers to organize. Criticism from Republicans has dogged the board's most prominent member, Craig Becker, who spent 20 years as a lawyer at the AFL-CIO and the Service Employees International Union. His nomination languished for 11 months in the Senate, leading Obama to give him a so-called recess appointment that bypassed confirmation. The appointment only lasts to the end of this year. Obama on Jan. 26 renominated him for a three-year term, but it will be even easier for Republicans, having picked up six seats in the midterms, to block him now.

Still, the move pleased the unions and is in stark contrast to the White House's recent pro-business pivot. With the terms of Becker and the board's Democratic chairman, Wilma B. Liebman, expiring this year, some say the NLRB is in a hurry to leave an impression. "Their view is that, during the Bush years, enforcement has not been as vigorous as it should be," says Marshall B. Babson, who served on the board from 1985 to 1988. "They want to put as much teeth into it as they can now." —*Stephanie Armour and Holly Rosenkrantz*

The bottom line *Business groups are pushing back against National Labor Relations Board rulings that would make it easier to organize.*

Quoted

"If we ask for it, they'll build it. If we buy it, they'll produce it."
—Michelle Obama telling reporters at a Feb. 8 lunch that, as part of her bid to end childhood obesity, she hopes to shape consumer demand so manufacturers will have to make healthier foods



The Budget

The Budget Proposal Most Everyone Will Hate

▶ **The President's spending cuts won't win him a lot of friends**

▶ **"Too much spending, too much taxing, and too much borrowing"**

As President Barack Obama prepares to send his 2012 budget to Congress on Feb. 14, Administration officials have fanned out to offer tantalizing glimpses of the goodies it will contain, including help for cash-strapped state

At the website of the *Tacoma Weekly*, a "Pothole Pig" feature displays photos of a ceramic pig sitting in city potholes. It's the site's ninth-most-visited item



Portion of U.S. urban roads that are in poor condition **24%**

unemployment programs, a method for consumers to immediately claim a $7,500 tax credit on electric vehicles, a six-year, $53 billion program for construction of a national high-speed rail network, and new investment in high-speed wireless services. Now, both parties are waiting to hear how he plans to pay for it.

While the President has made clear he is determined to get a handle on the ballooning U.S. deficit, he has given few specifics. His only substantive proposal so far—a federal spending freeze that would yield $400 billion in savings over 10 years—underwhelmed congressional Republicans, some of whom have called for $100 billion in cuts this year alone. As House Speaker John Boehner prepared to go to the White House on Feb. 9 to meet with Obama, he said he expected the budget to be more of the same: "too much spending, too much taxing, and too much borrowing."

He may be in for a surprise. Obama's budget won't win him a lot of friends, say sources familiar with the document, which is likely to be shot through with deep spending cuts in domestic programs that Democrats cherish, including heating oil assistance to the poor. Budget Director Jacob J. Lew outlined in a Feb. 5 *New York Times* op-ed some $775 million in 2012 cuts, including $350 million from community services funding, $125 million from the Great Lakes Restoration Initiative, and $300 million from Community Development Block grants—all programs close to the President's heart. The Defense Dept.'s budget request, meanwhile, will reflect cuts of $13 billion, the first slice of $78 billion in reductions over five years that Lew's office asked the Pentagon to make. In the op-ed, Lew said Obama will extract some savings by eliminating such programs as **Boeing**'s C-17 military cargo plane.

In a Feb. 8 interview, Lew signaled Obama wouldn't back a specific proposal for overhauling corporate taxes in the budget blueprint, though he plans to continue discussions with lawmakers and corporate executives. "The best way to get to a positive outcome is get broad agreement on the goals and work toward them," Lew said.

—Roger Runningen and Hans Nichols

The bottom line *The Obama Administration's 2012 budget due out Feb. 14 may contain surprisingly austere spending cuts.*







Transportation

Welcome to the Pothole Nation

▶ Citizens fill in as cities and states lack funds for roadwork

▶ "There's just no identifiable source for the money"

Steve Shaya grew tired of looking at a pothole in his street in the Detroit suburb of Hamtramck. So the 45-year-old civil engineer bought about $20 worth of asphalt patch and filled the hole himself last summer. "It was not only an eyesore, it was unsafe," he says.

For many Americans, the nation's rutted roads are among the most visible unhealed wounds of the Great Recession. Repairs have become an unaffordable luxury for cash-strapped cities and states. Now pols elected in November's Republican surge are preaching fiscal restraint and vowing not to raise taxes. Gasoline tax receipts, which provide federal and state cash for roads, are down—a result of fewer miles being logged and a switch to more efficient cars. Combined with severe winter weather putting more than the usual stress on roads, it all adds up to a pothole-infested nation.

Hamtramck, a city of 20,000, has asked Michigan to let it file for bankruptcy protection. There isn't enough spare cash to repave a single street, says Mayor Karen Majewski. The blight has spawned blogs about potholes and websites such as savemytire.com, where motorists from around the country can download smartphone applications listing the locations of gaping holes. The website for the *Tacoma Weekly*, a community newspaper in Washington, reports a boost in readership for its "Pothole Pig" feature—photos of a ceramic pig positioned in some of the city's more spectacular potholes, as chosen by readers.

Humor aside, the parlous condition of roadways is likely to get worse. States face deficits of $125 billion in the next fiscal year, says the Center on Budget and Policy Priorities. They have only about $9.4 billion in federal stimulus funds remaining for roads, according to Ken Simonson, chief economist for the Associated General Contractors of America. About half the organization's members expect construction spending to fall this year. Just 14 percent foresee an increase. "The outlook is very bleak," Simonson says.

This fiscal year's projected $1.5 trillion federal deficit is also part of the problem. House Budget Committee Chairman Paul Ryan (R-Wis.) on Feb. 3 proposed trimming nonsecurity, discretionary programs to 9 percent below 2010 levels, for a $43 billion cut over the seven months ending Sept. 30. House Republican leaders also rewrote procedural rules so budget cutters could restrain spending from the federal Highway Trust Fund, which faces insolvency next year without an influx of money.

CLARE JENSEN/TACOMA WEEKLY; JONATHAN ALCORN/BLOOMBERG; DON RYAN/AP PHOTO; DEB LINDSEY/THE WASHINGTON POST/GETTY IMAGES; JOHN WILCOX/BOSTON HERALD/POLARIS; JONATHAN ALPEYRIE/POLARIS; THE COMMERCIAL APPEAL/ZUMA PRESS

Annual average cost per vehicle for repairs caused by potholes and bad pavement

$402

EZ Street, a cold-asphalt manufacturer in Miami, sells a DIY solution for about $20: "The Pothole Patch," a 35-pound bag of premixed asphalt that "works in any temperature"




Boston


Portland, Ore.


Washington, D.C.

New Jersey's transportation trust fund is forecast to run out of money for new projects this year as debt payments eat up all its revenue. New York is short of cash for needed projects, such as a replacement for the 55-year-old Tappan Zee Bridge. California, with a budget deficit of $25 billion, spends less than half of the $6 billion a year needed to keep its roads repaired, says James Earp, a state transportation commissioner who heads a construction industry trade group. "There's just no identifiable source for the money, and I don't see that there will be anytime soon," he says.
—William Selway with Raquel Christie

DATA: THE ROAD INFORMATION PROGRAM

The bottom line *America's rutted roads are likely to decay further as Congress, states, and cities balk at new taxes and instead look for spending cuts.*

Energy

Obama's Trump Card On Oil Subsidies

▶ The President (again) calls for cutting oil industry tax breaks

▶ "I would be surprised if it got a great deal of traction" this time

President Barack Obama's call to eliminate tax breaks for profit-rich oil companies was a Democratic crowd pleaser during last month's State of the Union address. He had already proposed curtailing the $4 billion-a-year subsidy twice in the last two years, only to be turned back by industry lobbying and lawmakers in both parties. So his decision to mention it again raises the question: Can Obama make it happen this time?

The obstacles are formidable. With Republicans setting the House agenda, there's little chance Obama's initiative will advance in that chamber. His environmental allies may not be much help in pressing the issue, either. They have their hands full trying to beat back a GOP bid to gut the Environmental Protection Agency's curbs on carbon emissions and other anti-pollution programs. In the Senate, where Democrats are seven votes short of the 60 needed to pass most measures, Republicans quickly branded a similar proposal the "minivan tax."

Even some Democrats are balking. Scarcely a week after Obama delivered his applause line, Senator Jeff Bingaman (D-N.M.), the chairman of the Energy Committee, said ending the tax breaks "didn't get any traction" the last two years, "so I would be surprised if it got a great deal of traction" this time.

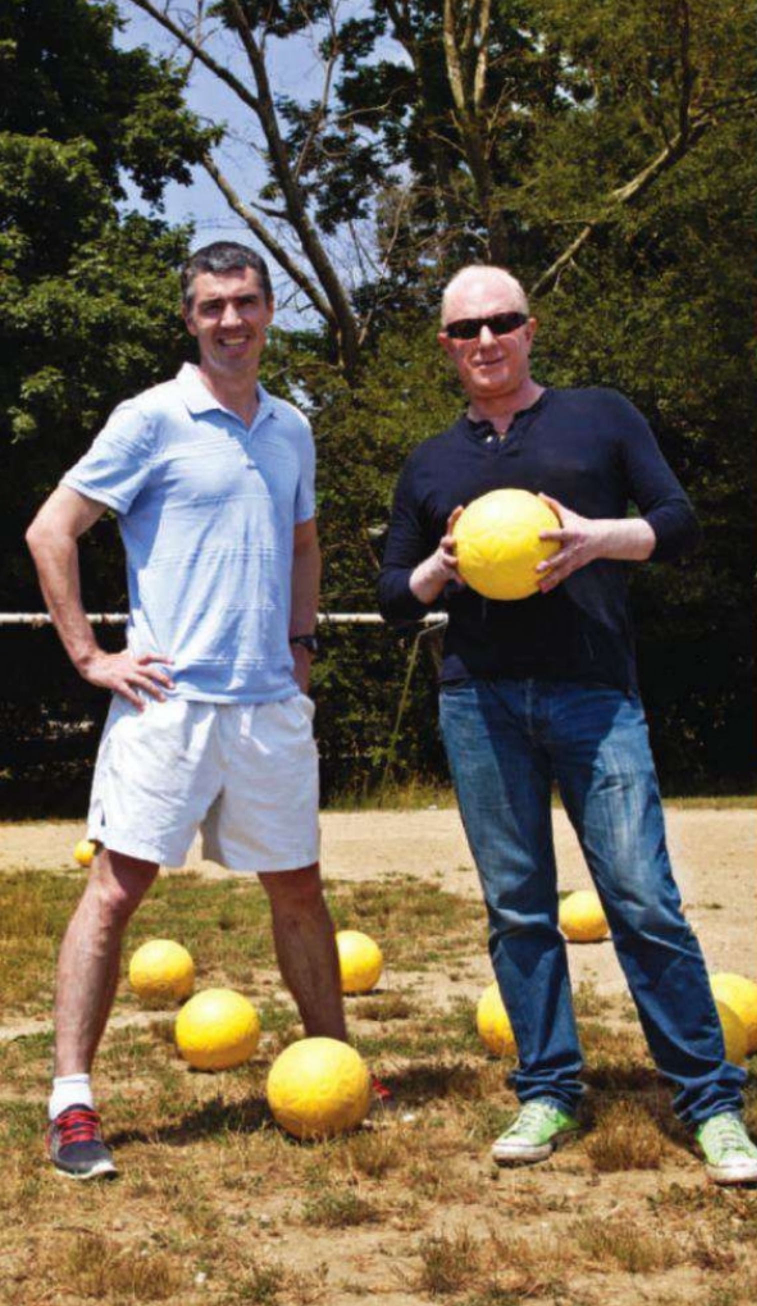
Bingaman and six other Senate Democrats joined Republicans on Feb. 2 in rejecting a proposal to remove $22 billion in oil-and-gas tax breaks to pay for ending an unpopular tax-reporting mandate, which requires businesses to report transactions above $600 to the IRS. Senator Mary Landrieu (D-La.), another of the seven, says Obama's "counterproductive" targeting of the industry is puzzling, given what she claims are 9.2 million U.S. jobs it provides. "To continue to single out the industry, I just don't think is right, and it's really not smart politics either," she says.

The companies' pitch to lawmakers is that no matter what they think of the industry, at least it pays taxes. Oil and gas companies pay higher effective tax rates than most U.S. multinationals, according to a Bloomberg analysis of 2005-2009 company data. The oil lobby also claims the loss of subsidies will hamper job creation, an Obama priority. With oil prices rising and the Mideast in turmoil, the argument against reducing domestic production by cutting exploration subsidies has also gained heft. "Singling out the oil and natural gas industry through tax increases is bad public policy," says Eric Wohlschlegel, an American Petroleum Institute spokesman.

The President has one powerful card he can play: GOP leaders say there's no limit to the amount of spending they're willing to cut to rein in the deficit. Tea Party Republicans, moreover, have fewer industry ties than party regulars, and many view subsidies as corporate welfare. Obama will test both factions, especially as he is keen to find reductions without touching his spending priorities, including education, research, and infrastructure. Oil companies that, in the President's words, are "doing just fine on their own" make an attractive target. Senate Majority Leader Harry Reid began the bluff-calling on Feb. 8, asking House Speaker John Boehner to close $20 billion in "loopholes for big oil and gas companies" over the next 10 years to start the belt-tightening. If they won't go along, Obama and his Democratic allies will be able to say Republicans aren't as committed to tackling the deficit as they claim to be. *—Julie Hirschfeld Davis*

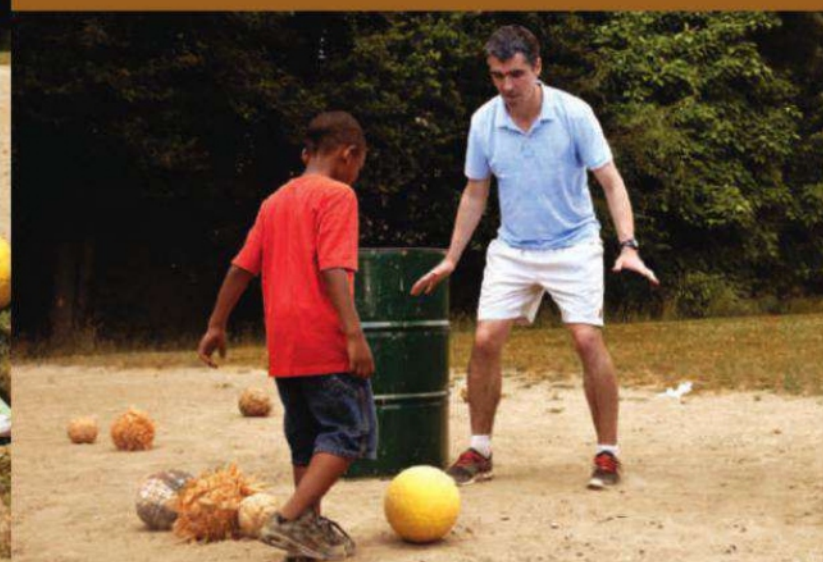
The bottom line *Obama's call for ending oil and gas subsidies gives him a counterpunch to Republican efforts to slash spending for his priorities.*

WorldMags



THE BEST PART OF GIVING SOCCER BALLS TO KIDS IN AFRICA IS SEEING THE LOOK ON THEIR FACES.

-Tommy Clark, Grassroot Soccer founder





Tommy Clark uses soccer to teach kids in Africa about AIDS. Sounds crazy, but it works. His organization's success relies on his supportive partners. So, when the kids' makeshift balls proved a problem, he found philanthropist Bobby Sager, who donated 10,000 indestructible Hope Balls after meeting face-to-face.

Last year at British Airways, we put hundreds of small business owners in front of the people they needed to see – for free. This year we're doing it again.

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Technology



Who You Calling A Data Hog?

▶ **Smartphone power users may not be the problem the wireless industry would have you believe**

▶ **Casinos call their best customers "whales." In wireless, they're stigmatized as gluttons**

Thirty dollars for unlimited data: This is how **Verizon Wireless** beckoned **AT&T** customers as it took orders for iPhone contracts on its network. Poor AT&T capped its data plans last year at $25 for two gigabytes; one gig is about the size of an episode of *Glee* in standard definition.

Verizon then said in a two-paragraph notice buried on its website that its network was a "shared resource" among its customers. It further sighed that it would have to slow data speeds for the top 5 percent of its users to save its customers from the "inordinate data consumption of just a few users."

In other words, the bandwidth hogs are ruining it for everyone. It's a curious phrase, "bandwidth hogs." Executives at **Comcast** used it earlier this decade to justify limiting traffic on file-sharing sites. This week several newspapers, writing about Verizon's decision, used the phrase "data hogs" in headlines. The phrase suggests a moral failing: the sin of gluttony.

Wireless data is a finite resource. Data moves from a tower to a cell phone over electromagnetic spectrum, which carriers buy at auction from the federal government. Each carrier has a limited amount of spectrum, yet that limited amount renews itself, moment after moment. Think of electricity: The power plant runs all the time, but on hot days everyone turns on an air conditioner, straining the plant's capacity. Utilities are experimenting with smart meters that encourage customers to move their power use off-peak.

Wireless carriers, responding to a similar challenge, have chosen not to treat data like a commodity. Rather, they've carved off 5 percent of their heaviest users and stigmatized them. This is a business choice, not a natural economic consequence. Imagine that a power company, to prevent blackouts, has informed its customers that its heaviest users will be penalized with unpredictable brownouts two months running. Why do wireless customers tolerate this from carriers?

Some people do use a lot of

ILLUSTRATION BY GRAHAM ROUMIEU

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data. This month, **Cisco Systems** reported that the top 1 percent of wireless data customers account for 20 percent of traffic. In any other industry, this market segment would be called "loyal customers." Casinos call them "whales" and give them free hotel rooms and special tables with high limits. Wireless carriers punish their whales.

Verizon has hinted that, like AT&T, it plans to move to tiered pricing later this year. Meanwhile, according to analyst Craig Moffett of AllianceBernstein, AT&T is quietly letting some customers who used to have unlimited plans return to them. Carriers are playing two games of chicken simultaneously. First, among themselves: Each wants to earn more per customer by charging extra above a certain data limit, but none wants to be the first to do so. Second, with the rest of us: How low can they cap data without offending too many customers?

It's hard to tell how much carriers pay wholesale to provide bandwidth to customers. According to John Hodulik, an analyst for UBS, "It's just not something the telcos discuss." A paper last year by Merrill Lynch calculated $3 per gig and falling. (Verizon and AT&T declined to provide figures.)

Assuming that estimate is correct, almost every customer is buying data at a painful markup. AT&T's basic plan is 0.2 gigs for $15 a month, which equals $75 per gig. That's a 2,500 percent markup over the cost of goods for, according to Cisco, almost three-quarters of all mobile users. For AT&T's next tier, the markup drops to about 400 percent. Ostensibly, AT&T is worried about running out of spectrum, but its tiered structure, which provides little incentive for minimizing data use, doesn't seem engineered to save bandwidth.

One time-honored way of allocating a scarce resource is to agree on a unit—a barrel of oil, a kilowatt-hour, a *Glee* of data—and let the price of that unit fluctuate according to demand. Some refer to this mechanism as a "free market." But if the wireless carriers were to charge by the gig, even if the market arrived at a generous 1,000 percent markup, they'd lose money over the tiered setup AT&T has in place now. No wonder wireless carriers prefer the language of tiers, caps, and hogs to a simple per-gig price.

Analysts and shareholders prefer the current pricing structure, too. Let's be clear, though: Tiered data prices are not in place to save bandwidth. Data hogs aren't the problem the carriers would have us believe (Cisco has 0.4 percent of customers using more than 5 gigs a month), and the other customers are very profitable. Dave Burstein, an analyst for DSL Prime, estimates that if capacity were the only factor, no carrier would need to introduce a limit under 10 gigabytes. The carriers are like sadistic Italian grandmothers: "Eat, eat," they say, but then, "You're too fat."

The era of unlimited plans does have to end. The best way to allocate finite goods is through transparent, efficient markets. As traffic increases on mobile networks—it nearly tripled this year, and Cisco expects it to grow twenty-sixfold by 2015—consumers will be forced to make smarter choices about how they use mobile data. Perhaps parents will be forced to download the toddler-pacifying Elmo videos at home rather than on-demand in the car. That's not a tragedy, it's what markets do. So the next time you hear a wireless executive complaining about data hogs, ask yourself: What's my reward for being a data piglet?
—*Brendan Greeley*

The bottom line *The heaviest mobile users get stigmatized as data gluttons, and yet carriers charge them the lowest markups.*

101

MILLION

The number of smartphones shipped in the fourth quarter of 2010—the first time they outsold PCs

DATA: IDC

Akamai's network command center in Cambridge, Mass.



AKAMAI TECHNOLOGY INC./BLOOMBERG

Networks

Psst! Wanna Buy a Content Distributor?

- Oft-rumored acquisition target Akamai says it plans to go it alone
- "They've been the Cadillac of the industry," says a competitor

Akamai Technologies has been a rumored takeover target 21 times since 2005, more than any other company, according to Bloomberg data. Chief Executive Officer Paul Sagan insists nobody there is paying attention. "I get more questions from employees about whether we can get more showers in the office," he says. Told that Akamai had been crowned king of the rumor mill, he laughs: "Well, I guess that makes you guys wrong more often than anyone."

The takeover chatter has included **Apple**, **AT&T**, **Cisco Systems**, and **Google**. Although shares of the Cambridge (Mass.) company with the funny name (it means "intelligent" in Hawaiian) tumbled nearly 12 percent on Feb. 9 after a weaker-than-expected forecast for the current quarter, Akamai still trades at roughly 50 times earnings. Apple, by comparison, trades at about 20 times profits. It's a sign that Wall Street expects Akamai's sales to keep zooming upward—revenue increased 19 percent in the fourth quarter of 2010, to $285 million.

WorldMags



The company is known for its dominance in the $2.5 billion market for content delivery network, or CDN, services. Content providers such as video sites and media companies pay a monthly fee to cache their content on Akamai's 77,000 servers in 71 countries. The company's network–which amounts to a more reliable, faster Internet–handles roughly 15 percent of all Web traffic, more than any other CDN and more even than Google, says Sagan.

Media companies use CDNs to distribute their articles, movies, and music. When a sports fan in Wisconsin presses "play" on a Super Bowl clip, the video comes from the nearest Akamai server rather than NFL.com's data center in El Segundo, Calif. "They're like a giant shock absorber," says Hans Schroeder, NFL.com's senior vice-president of media strategy and development. "When millions of people hit the site on Sunday, Akamai's ability to handle the load through their dispersed network is tremendous."

Rival CDN providers such as **Limelight Networks** and **Level 3 Communications** have pushed down the price Akamai can charge for basic CDN services. Sagan says the company's sales volume will make up for falling prices: Growing demand for Internet video delivered to everything from iPads to big-screen TVs will drive Akamai's CDN business from $400 million today to $2 billion within 10 years, he says.

Sagan, a cousin of 1980s scientist Carl Sagan, is also expanding Akamai's offerings. The company now takes in roughly $200 million a year from e-commerce sites, helping to cut seconds off the time it takes to deliver product recommendations to shoppers. It recently started a service that stores credit-card numbers for e-tailers. With Akamai maintaining the actual database of card numbers, merchants can forgo the expensive security audits demanded by payment processors, potentially saving them millions of dollars. Plus, e-tailers eliminate the risk of having thousands of credit-card numbers stolen.

Akamai has begun to sell to big corporations, too, letting them pay a monthly service fee rather than take on the cost and complexity of building sophisticated IT shops of their own. It offers security services to protect against denial-of-service attacks like the ones WikiLeaks supporters launched against sites run by **Visa** and **MasterCard** in December. Akamai's servers are programmed to spot and block suspicious traffic. Tom Leighton, a former Massachusetts Institute of Technology professor and one of Akamai's co-founders, says this strength-in-numbers approach is the only way to defeat massive cyber assaults. Most sites "just can't afford to fight off some of these attacks" on their own, he says.

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Times that Akamai has been rumored an M&A target since 2005

As Akamai expands into new markets, competitors are edging in on its core business. Level 3 won the high-profile **Netflix** account away from Akamai in late 2010. Telecom companies such as AT&T are adding content distribution capabilities to their phone networks. Barrett Lyon, who co-founded rival **Bit Gravity** (which was recently sold to **Tata Communications**), is about to launch a new video distribution company. "They've been the Cadillac of CDNs with Ferrari prices," he says of Akamai. "But someone is going to come along and solve customers' problems more economically."

With that in mind, wouldn't Akamai be better off under the protective umbrella of a large acquirer? Sagan says it's not an option. He thinks the company is better off on its own, free to market to and partner with anyone rather than be handcuffed by a parent company's strategic goals. "We don't get intimidated," he says. "And we don't take no for an answer." —*Peter Burrows*

The bottom line *Akamai, the "shock absorber" of the Internet, is diversifying into e-commerce, network security, and other businesses.*

E-Publishing

In Cramped Japan, the IPad Is the Home Library

▶ **Families save space by paying startups to digitize their books**

▶ **"Publishers are not meeting the market's needs" for e-books**

After his son was born in 2009, Satoshi Tagomori started having nightmares that the bookshelves lining his cramped living room would rain heavy tomes on the infant. Armed with a cutting board, the 28-year-old pharmaceutical company employee chopped his 850 titles to fit inside a cheap scanner and converted each book into a PDF file. His library now lives in his preferred tablet computer, a **Samsung** Galaxy Tab. "There was just no more room for books when my son was born," he says.

Japan's famously small living spaces–the country's average

Technology



Getting billions for Madoff's victims
page 38 ▶

home size is half that of the U.S.—make it a natural market for such space-saving innovations as digital books. Japanese have taken to tablet computers, especially **Apple**'s market-leading iPad. While the iPad has opened the doors for e-books, the publishing industry has been slow to walk through them and still offers few Japanese-language editions. A cottage industry of pulp-to-PDF scanning startups are filling the void and now offer to digitize books for a modest fee.

Some Japanese, such as Tagomori, are doing the scanning on their own. **Fujitsu**'s PFU scanner-manufacturing subsidiary says sales of its consumer models rose 80 percent in June, the month after the iPad was released, and more than doubled the following month. The Tokyo-based company had to charter special flights from its China factories to meet demand, according to Tadashi Oura, PFU's head of marketing.

Publishers have been slow to react to the change in reading habits in part because they're reluctant to offer digital titles at reduced prices, as is common in the U.S., says Toshihiro Takagi, an analyst at market researcher Impress R&D. It also took time to develop standards for how Japanese characters, which are read from top to bottom rather than left to right, should be displayed on various screen formats. "People are taking matters in their own hands because the publishers are not meeting the market's needs," says Toshihiro Takagi, an analyst at Impress.

One of those people is Yusuke Ohki, a 28-year-old entrepreneur in Tokyo. As pre-release iPad fever hit Japan last April, Ohki and a childhood friend, Shinya Iwamatsu, founded **Bookscan**. The startup charges 100 yen, or $1.22, to digitize a book and produce PDFs replete with original highlighting and marginalia. After Takafumi Horie, a well-known Internet entrepreneur, tweeted about the company, a wave of media attention followed. Bookscan now has 140 employees and about 12,000 customers. Despite plenty of competition—Ohki estimates Bookscan is one of 60 such companies—the startup has a four-month waiting list.

Independent book scanners are filling a void but may also create headaches for copyright owners. Under Japanese law, book owners are allowed to digitize their libraries for personal use, but there's always the risk that "these homemade contents begin to circulate illegally," says Nobuo Kurahashi, an analyst at Mizuho Financial Group in Tokyo.

—Pavel Alpeyev and Yoshinori Eki

The bottom line *The rise of book-scanning startups in Japan is a sign of latent demand for e-books, which publishers have been slow to meet.*



A Bookscan worker in Tokyo preps a volume

New Media

$315M for Us. You? A Sense of Job Well Done

▶ **Huffington Post's sale to AOL has contributors looking for their cut**

▶ **"I'd love to be paid, but it doesn't seem like it's in the cards"**

At 7:48 a.m. on Feb. 7, the morning after AOL executives had completed a deal to purchase the Huffington Post for $315 million, the thousands of actors, authors, activists, academics, and comedians who collectively make up the blogging corps of the Huffington Post received an e-mail from the site's founder.

"Thank you," Arianna Huffington wrote, "for being such a vital part of the HuffPost family—which has suddenly gotten a whole lot bigger."

Huffington assured the bloggers that although her role is shifting—she will oversee all content at the new, merged venture—their roles aren't. "Together, our companies will have a combined base of 117 million unique U.S. visitors a month—and 250 million around the world—so your posts will have an even bigger impact on the national and global conversation," she wrote. "That's the only real change you'll notice—more people reading what you wrote." Conspicuously unmentioned: the subject of pay.

Since its launch in 2005, the Huffington Post has relied on unpaid contributors to stock the news-and-aggregation site with myriad opinions on everything from health care to Palin hair. It's an arrangement unlikely to change soon. "We're in the business of paying people for original reporting," says Roy Sekoff, the site's founding editor. "If people want to express their opinions, they do so on the site for free."

Sekoff, who will play a major (so far unspecified) editorial role in the new organization, says it's too early to say how the volunteer model might apply to the AOL blogs that do pay, which include TechCrunch, Engadget, and PopEater. "We haven't done all the nuts and bolts yet," says Sekoff. As rumors circulated about the size of Arianna Huffington's payday, some questioned the fairness of the compensation model.

CLOCKWISE FROM BOTTOM LEFT: KIMIMASA MAYAMA/BLOOMBERG; TIMOTHY A. CLARY/AFP/GETTY IMAGES; JIN LEE/BLOOMBERG; BRAD TRENT

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Charlie Rose talks to Tim Armstrong & Arianna Huffington

“This deal happened because Tim and I had the same vision, literally”



On the day they announced their $315 million union, AOL's CEO and the Huffington Post's co-founder describe a speedy, out-of-the-blue courtship

Tell me how this happened.
Huffington: It started, actually, in November at the Quadrangle Conference. Tim was speaking. I heard him talk very honestly about the strengths and weaknesses of AOL. And he and I chatted after that. We met the next day at his office. And it was kind of amazing.

Armstrong: It was a meeting of the minds. We were finishing each other's sentences. Over the course of the next month or two we met several times. In between Christmas and New Year's, I e-mailed Arianna and said, “Do you mind if we come out and visit you in California?” We went out and had lunch at Arianna's house–Artie Minson, who is our CFO, and I. Over the course of that lunch, that's really where we got serious about putting a deal together.

What makes this a win-win?
Armstrong: We just did a research study last year. People typically use 20 content brands a month on the Internet. They use 14 on cable television. If you connect the dots ... all of that has got to be fueled by content. And if you look at a property like the Huffington Post or other properties of ours, it's not hard to marry those two visions together and think that the most important thing in the next phase of the Internet is going to be content.

Arianna, what's your role now?
Huffington: I become the president and editor-in-chief of the Huffington Post Media Group, which includes the Huffington Post and the AOL content sites, such as PopEater–the entertainment site–Engadget, TechCrunch. It's an opportunity to bring together what was done well at the Huffington Post, the engagement, a certain way that our news consumers don't just consume news. They share it. They tell their own stories. To bring that across all the AOL sites.

How did you make the decision to get the capital to grow through this deal, rather than by going public?
Huffington: We didn't need capital. We had become profitable. We could continue growing the way we had been growing–22 percent last year–without any additional capital. And we were not looking to sell. Our board wanted to do an IPO down the road. This deal happened because Tim and I had the same vision, literally, almost identical in terms of expanding local [coverage], launching internationally, building community, doing a lot more in the women's space, and a lot more around causes and cause marketing.

Some have called this a Hail Mary pass for AOL.
Armstrong: That question came up because when I came into AOL it was inside of Time Warner and they had done the [$850 million] Bebo acquisition, which a lot of people concluded to be a Hail Mary. First of all, since I've got the company, I invested my own money into the company. There are no Hail Marys. We have a very specific laser-focused strategy. We have a very strong vision for where the Internet is going. That's why I think Arianna's at this table right now, because you don't get people like Arianna Huffington unless you have a strong vision.

Who's your competition now?
Huffington: We're competing against ourselves because what we are doing is providing great content across all platforms. AOL has an incredible investment in video–and we intend to double down on that–a great investment in local [coverage] just in time for the Presidential election, over 800 towns already being covered by professional journalists.

So the challenge is to do it on a bigger scale?
Armstrong: One of the unique things we're bringing to the table is, we are going to be the first digital content company that is going to connect on a global, national, and local basis. We will be the largest single affiliate network on the Internet space in the U.S. And that's powerful.

I've written one blog in my life, and it came about because I was having dinner with Arianna.
Huffington: The first person I invited to blog was Arthur Schlesinger. He said to me, “How do you use a computer?” I said, “Don't worry. Fax it to me.” Rahm Emanuel, Larry David, they call and dictate their blogs to us from the stairs, the golf course. The important thing is: Here's a platform that's available whenever they have something to say. That is now only going to be amplified. B

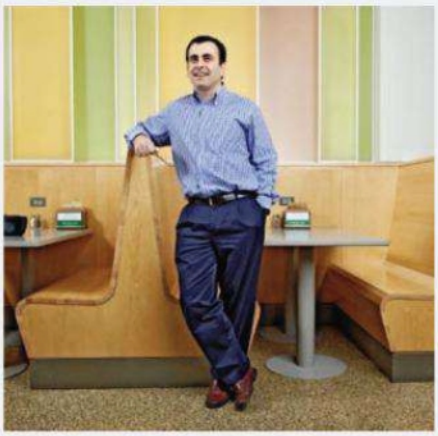


Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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Innovator

Alberto Cavallo



The economist developed software that calculates real-time inflation by tracking 5 million products sold on 300 e-commerce sites

To track inflation, each month the Bureau of Labor Statistics canvasses businesses and records the price of, say, a 4.4-pound bag of golden delicious apples, among hundreds of other items. The agency dials land lines to survey how consumers spend their money. It's essentially the same process the BLS has used for half a century. In a recent budget request, the agency admitted its methods are "increasingly out of touch" in the age of cell phones and e-commerce.

Alberto Cavallo's Billion Prices Project may be a way to bring that process into the 21st century. Each day, software developed by Cavallo, a 33-year-old economist at Massachusetts Institute of Technology, scours the websites of roughly 300 online retailers and records the prices of some 5 million goods sold on the Web. "The technology is very similar to what Google uses to index Web pages," says Cavallo. The software, which Cavallo and his colleague Roberto Rigobon have fine-tuned over the past three years, spits out a daily estimate of price changes.

The BPP's focus on delivering real-time data "is paramount for businesspeople and policy makers," says James Hamilton, an economist at the University of California at San Diego. A week after Lehman Brothers collapsed in 2008, the BPP registered falling prices across the U.S. The BLS's official measure of inflation, the consumer price index, didn't report deflationary numbers until 56 days later. Cavallo says the BPP is currently running higher than official inflation estimates, and expects the latter to catch up soon. "I don't consider it an alarming trend," he says, "but it's worth watching closely."

A limitation to the BPP, says Hamilton, is that "not everything is traded on the Internet." Certain transactions, including real estate sales and services like medical care, still take place mostly offline. Yet Hal Varian, Google's chief economist, notes that one of the key benefits of the project may be that "it isn't filtered through a statistical agency which, for some countries, cannot be entirely trusted." Indeed, Cavallo, who spent much of his childhood in Buenos Aires, began an Argentina-only precursor to the BPP in 2007 because, he says, government officials had "started manipulating their inflation statistics." In such cases, he says, the BPP can serve as a private-sector check on officialdom.

Cavallo is a second-generation economist. His father, Domingo Cavallo, headed Argentina's Finance Ministry during the 1990s, and helped engineer the policies that cured the country of hyperinflation. The younger Cavallo emigrated in 2003 and got an economics PhD at Harvard. He views the BPP as a public resource—he has no plans to make money on it—and has made presentations to government officials about how it can complement their efforts. "The next challenge is to understand how governments can use this information to make better decisions," he says. —*Barrett Sheridan*

Cred ▶ **MIT economist; father helped cure Argentina of hyperinflation**

Technology ▶ **Tracks prices with software "similar to what Google uses"**

Benefit ▶ **Complement to official stats that could keep governments honest**

Technology

Dan Gillmor, the director of the Knight Center for Digital Media Entrepreneurship at Arizona State University, wrote that Huffington should cut checks to "the most productive contributors on whose work she's built a significant part of her new fortune."

Sekoff says the grumblers are a minority who show up whenever the site's finances are in the news. "No one has ever tried to fool anybody," says Sekoff. "When we started we had 500 contributors. Now we've had close to 15,000 people blogging at least once. They came to us and said, 'Please, can my stuff be on your site?' "

Currently, the Huffington Post has 255 paid employees, including 148 editorial staffers. Sekoff says the site invests much time and money in preparing bloggers' submissions for publication—editing the content, optimizing it for search engines, and moderating the millions of comments attached to posts every month. "It's a symbiotic relationship," says Sekoff.

Loyal contributors have long since grown accustomed to laboring gratis. "I'd love to be paid, but it doesn't seem like it's in the cards," says Bob Cesca, who has been writing a popular weekly political column since August 2005. He says his exposure on the Huffington Post helped him land a book deal in 2008, and that traffic from his columns generates enough ad revenue on his personal blog to cover "beer money."

Sekoff points out that plenty of bloggers don't need the money. Dan Rather, the former *CBS Evening News* anchor, who writes roughly three items a month for the Huffington Post, says he's "empathetic to those who are scrambling for an income and take the position, 'well, it's time to start paying something.' "

Comedian and regular Huffington Post contributor Andy Borowitz recently took to Twitter to weigh in on the deal. "My share of the Huffington Post sale, zero dollars, was a little disappointing," he tweeted. Asked by *Bloomberg Businessweek* to elaborate, Borowitz seemed ready to explore a new pay model. "I will be happy to make a comment," Borowitz replied via e-mail, "if you will pay me." Ⓑ
—*Felix Gillette*

The bottom line *The Huffington Post, bought by AOL for $315 million, prospered with an army of unpaid bloggers. Some want a piece of the action.*

PHOTOGRAPH BY MICHAEL WARREN FOR BLOOMBERG BUSINESSWEEK

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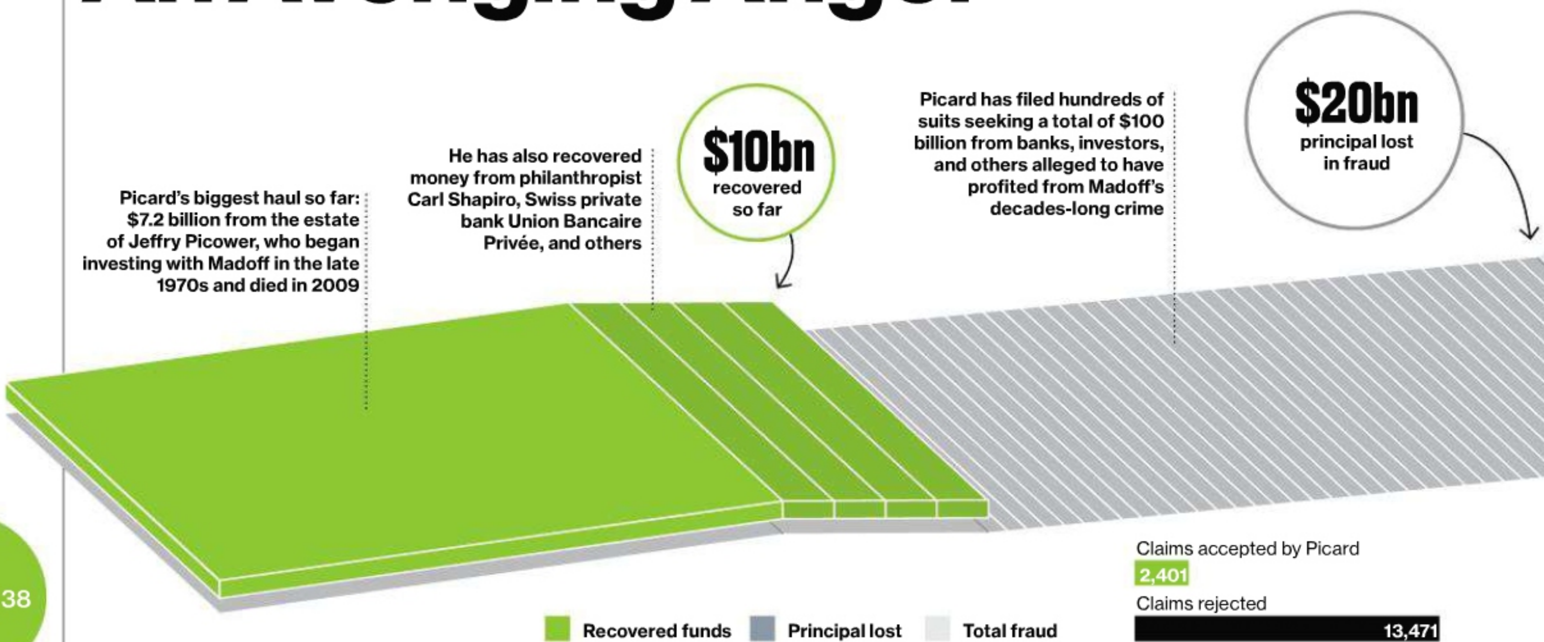
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Contents ▶ Carlos Slim beats out Buffett and Gates—again 40 ▶ Low rates help the commercial property market 41 ▶ Sales growth shows basic business demand is strengthening 41 ▶ Bid & Ask: 3M's $7 billion stock buyback 42 ● Edited by Eric Gelman

Markets&Finance

For Madoff Victims, An Avenging Angel



▶ **Picard has $10 billion in hand and is suing for $100 billion more**

▶ **"He's consistently taken the most aggressive position"**

When Bernard Madoff's investment firm collapsed in history's biggest Ponzi scheme more than two years ago, Irving Picard was appointed to the daunting job of trying to collect some of the $65 billion purportedly in customer accounts. Now, with about $10 billion in hand, Picard may be on his way to recovering the $20 billion in principal he estimates was lost to Madoff. And as he pursues hundreds of lawsuits seeking $100 billion from banks and others he claims profited from the fraud, he may be able to give some victims something Madoff never even tried to deliver—a return on their investment.

His strategy is simple. "We're looking to collect as much money as possible," Picard said outside court Jan. 13, after a bankruptcy judge approved a $7.2 billion settlement Picard and U.S. prosecutors reached with the estate of Jeffry Picower, a Madoff investor who died in 2009. The Picower settlement—the biggest of its kind—underscores the tricky position Picard is in: To return money to Madoff's victims, he has to first take it from somebody else. Picard's choices about whom to pay and whom to sue have led some victims to feel wronged again.

"He's doing what the receiver is supposed to be doing ... going after deep-pockets he believes could have put an end to the fraud," says John V. Donnelly III, a partner with the law firm Cozen & O'Connor in Philadelphia, who represented an investor in recovering assets frozen in R. Allen Stanford's alleged $7 billion fraud.

Sandra Mayerson, a bankruptcy lawyer with the firm Squire Sanders in New York, says Picard has made several decisions that paid off, including seeking additional funds from investors he claimed should have known they were profiting from a fraud. "He's consistently taken the most aggressive position possible," she says, "and that's been very successful in recovering money for the estate."



Madoff told authorities his financial empire was "one big lie" in December 2008

Just days after Madoff told authorities his financial empire was "one big lie" in December 2008, the Securities Investor Protection Corp. named Picard, 69, trustee of Bernard L. Madoff Investment Securities, making him responsible for unwinding the biggest fraud in the agency's history. Picard, who graduated from Boston University School of Law in 1966, has worked for the U.S. Securities and Exchange Commission. When he was named Madoff trustee, the SIPC said Picard had liquidated more brokerage firms as trustee than anyone. A week later he announced he was leaving his law firm, Newark (N.J.)-based Gibbons, for the New York office of Baker Hostetler, a 650-lawyer firm based in Cleveland. At Baker Hostetler, he joined David Sheehan, 67, a friend and former law part-

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The Bill Collector
Irving Picard has been negotiating settlements and filing lawsuits to recover money for victims of Bernard Madoff's fraud

FROM LEFT: SHANNON STAPLETON/REUTERS/CORBIS; BRENT STIRTON/CONTOUR BY GETTY IMAGES

ner, who serves as his chief lawyer in the Madoff case.

In December, Picard filed a $19.6 billion suit against Bank Medici and its founder, Sonja Kohn, whom Picard called Madoff's "criminal soul mate," along with Bank Austria and UniCredit. Kohn, who hasn't been criminally charged, has said she was a victim of the fraud. Also in December, Picard sued HSBC Holdings for $9 billion and a group of banks including Citigroup and Bank of America for $1 billion. Picard alleges they profited from Madoff's decades-long fraud. The banks have denied wrongdoing and vowed to fight the lawsuits.

In complaints unsealed this month, Picard claimed Fred Wilpon and Saul Katz, owners of the **New York Mets**, and **JPMorgan Chase** had all the information they needed to discover Madoff was running a vast fraud and looked the other way instead of taking steps to expose him. The suits seek $6.4 billion from JPMorgan and as much as $1 billion from Wilpon and Katz. Jennifer Zuccarelli, a spokeswoman for JPMorgan, said in a statement that the bank wasn't aware of Madoff's fraud. The activity in Madoff's account was consistent with a legitimate investment advisory business, she says. Wilpon and Katz said Picard's suit against them is "an outrageous strong-arm effort to try to force a settlement by threatening to ruin our reputations and businesses."

If Picard and Wilpon and Katz decide to negotiate a settlement, they might model it on a deal made in connection with Bayou Group's Ponzi scheme, uncovered in 2005. In that instance, a partnership tied to Wilpon gave up $12.9 million, which represented all profits it made plus 44 percent of the principal, after a judge ruled that Bayou investors could be pursued if they had seen "red flags" that should have alerted them to the fraud.

The suit against Mets owners Wilpon and Katz "will strike fear into the hearts of a lot of people"

Mayerson says the case against Wilpon and Katz "will strike fear into the hearts of a lot of people, because if they should have known, then a lot of people should have known."

Not all of Picard's targets are banks or wealthy investors. Helen Chaitman, a New York City lawyer who was a Madoff investor, says she represents many people of relatively modest means whom Picard sued in the weeks leading up to the Dec. 11 deadline for him to file claims. The date, which was the two-year anniversary of Madoff's arrest, was also the day his son, Mark Madoff, committed suicide by hanging himself in his Manhattan apartment. Madoff, 72, is serving a 150-year sentence in federal prison in North Carolina.

Some individuals, known as "net winners," withdrew more from their Madoff accounts than they invested. Picard is suing hundreds of them to recover the fictitious profits he frequently refers to in legal papers

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it with no idea they were living off the proceeds of a fraud, says Chaitman, and many have no way to pay. "These people are frantic," she says. Even clients with approved claims, who are likely to receive money from Picard, have been forced to sell their claims to investors for 50¢ to 65¢ on the dollar because they need cash, she says.

In a December press conference and on his official website, Picard said he will use his discretion not to pursue claims against Madoff victims who can show that paying back their profits from the fraud would cause financial hardship. As of Feb. 4, Picard had allowed claims made by 2,401 former Madoff investors and denied more than 13,471, according to his website.

For Picard the work has been lucrative. So far the bankruptcy court has approved $119 million in legal fees for him and Baker & Hostetler. The money is to be paid by the SIPC, Picard has said in court papers. Work on the Madoff case accounted for at least $58 million of the firm's estimated $386 million revenue in 2010, according to *The American Lawyer*.

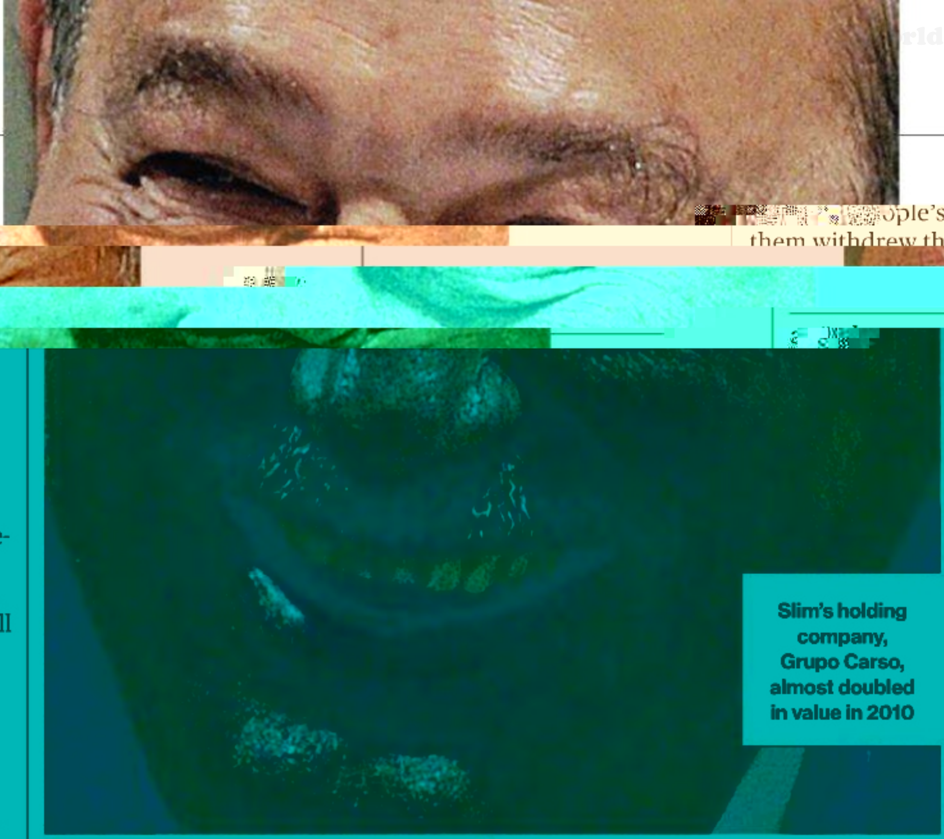
Chaitman, who has frequently opposed Picard in the Madoff case, credits him with uncovering details of Madoff's fraud, including the identities of many alleged accomplices that haven't come out through criminal prosecutions or an investigation by the SEC. "Thank God for Picard," she says.
—Bob Van Voris

The bottom line *Picard may be able to recover the $20 billion investors gave to Madoff, and possibly some of their supposed profits as well.*

Tweeted

"AOL to Buy Huffington Post; Tim Armstrong says '1 + 1 will equal 11' (NYTimes) ...Really? That wasn't my experience."
—AOL co-founder Steve Case





Slim's holding company, Grupo Carso, almost doubled in value in 2010

Wealth

Battle of the Billionaires: This Round Goes to Slim

- His fortune grew more than Gates's or Buffett's in 2010
- "Owning a monopoly with enormous pricing power"

Mexican billionaire Carlos Slim topped Bill Gates and Warren Buffett in the money game for the second straight year. The value of Slim's publicly disclosed holdings, in industries ranging from mining to telecommunications, surged about 37 percent, to $70 billion, in 2010, according to data compiled by Bloomberg. The 22 percent jump in **Berkshire Hathaway** shares wasn't enough for Buffett to catch up, and Gates's **Microsoft** stock fell 8.4 percent, hurting his returns even as he spread his investments to other companies.

Slim's best-performing asset last year was holding company **Grupo Carso**, which almost doubled in value as it prepared for this year's spinoff of its mining operations amid soaring gold and silver prices. Grupo Carso also owns retail, manufacturing, and construction companies. Slim's biggest loss came from a stake in **New York Times**, which fell 21 percent. **Teléfonos de México**, the state-owned monopoly he acquired in 1990, was his second-worst investment in 2010, falling 8.7 percent. The carrier's 2001 spinoff, **América Móvil**, gained 15 percent. Slim's stake in the wireless company was worth $48.9 billion on Dec. 31. Slim, 71, and Gates, 55, both became wealthy through bets on new technologies and were helped by their dominant market positions, says Thomas Russo, who manages about $4 billion at **Gardner Russo & Gardner** in Lancaster, Pa.: "They basically had the privilege of owning a monopoly with enormous pricing power in markets that grew."

Buffett's returns were calculated from his shares of Berkshire Hathaway, his investment company that holds stakes in **Wells Fargo** and **Coca-Cola**. Berkshire's A shares gained 21 percent last year and its B shares rose 22 percent. At year-end, Buffett, 80, held a total of $46.2 billion in Berkshire stock. He gave $1.6 billion in shares to the Bill & Melinda Gates Foundation in July as part of his plan to donate 99 percent of his wealth. The data compiled by Bloomberg didn't include money given to charities.

Gates's publicly disclosed holdings amounted to about $26 billion at the end of 2010, down more than 8 percent from 2009. Microsoft stock represented $16.7 billion of the total, after Gates reduced his stake in the company by 80 million shares to diversify his investments. Neither Buffett nor Michael Larson, who runs **Cascade Investment**, which manages Gates's money, responded to requests for comment. In a news conference on Jan. 31, Slim said he would spend $3.66 billion on Mexican telecommunications, mining, and infrastructure projects. He did not comment on his 2010 returns.

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Mexico will be "the emerging market of 2011," says Walter Molano, head of research at BCP Securities in Greenwich, Conn. Growth will come from an economic expansion in the U.S., Mexico's top trading partner, and from investors looking for opportunities outside of Brazil, Russia, India, and China. "Slim is in for a very good year," says Molano.
—Crayton Harrison

The bottom line *Strong gains in his mining interests helped Slim top Buffett and Gates last year—and he's well-positioned for another good year in 2011.*

Real Estate

The Washout That Wasn't

▶ **Low rates helped the commercial property market avoid collapse**

▶ **Lenders have "wiggle room to work out these troubled situations"**

From Manhattan office towers to Florida apartment buildings to retail properties in Washington, commercial real estate values are rising, defying predictions made as recently as February 2010 of a collapse that would drag the U.S. economy back into recession. Prices of commercial properties sold by institutional investors surged 19 percent in 2010, the second-biggest gain on record, according to an index developed by the MIT Center for Real Estate.

Near-record-low interest rates mean buyers can get cheap financing, which improves their returns. At the same time, rising earnings give banks a cushion to absorb losses, enabling them to sell distressed properties rather than hang on to them. Investors, convinced the worst is over, have pushed prices on bonds backed by commercial mortgages to the highest level in two years. Says Dan Fasulo, managing director at New York-based Real Capital Analytics: "Now that values are on the upswing, it's given owners and lenders more wiggle room to work out these troubled situations."

Those taking advantage of improving conditions include **Vornado Realty Trust**, which in December resolved a standoff with its lender by paying $115 million to buy the $171.5 million loan on its Springfield Mall in a Virginia suburb of Washington. The loan had been transferred to a special servicer a year earlier because the New York-based real estate investment trust was in danger of "imminent default" on the property, according to Fitch Ratings.

In downtown Fort Lauderdale, a market damaged by declining home values, **USAA Real Estate** bought Las Olas Centre, a 469,000-square-foot office complex that had been seized by lender **Wells Fargo**. USAA Real Estate, based in San Antonio, paid $170 million in September; the previous owner spent $231 million near the top of the market in July 2007, according to Real Capital.

In February 2010, the Congressional Oversight Panel of the Troubled Asset Relief Program warned that a deteriorating commercial real estate market had the potential to wreck the U.S. economy. It estimated that almost half the $1.4 trillion in commercial property loans set to be paid off by 2014 were underwater, meaning the borrower owed more than the property was worth. Unless refinanced, the debt "could threaten America's already weakened financial system," the panel said in a report.

New York, Washington, and Boston are among the cities leading the recovery as employment growth and large inventories of properties with a lot of rent-paying tenants attract investors.

Market segments including hotels, apartments, and retail are also on the rise. A hotel rebound started last year, with the average occupancy rate in the top 25 U.S. markets rising to 64 percent from 60 percent in 2009, according to Smith Travel Research in Hendersonville, Tenn. Sales of apartment buildings nationwide rose in the fourth quarter as homeownership remained at a 10-year low and demand for rentals pushed lease rates to the highest in four years, according to Axiometrics, a Dallas-based research company. Of the $52 billion of retail properties to fall into default, just over half have completed workouts, "giving the retail sector the distinction as the first property type to pass the halfway point in resolving its distress," Real Capital analysts wrote in a January report.

"That tsunami of distress that had been forecast has not really materialized," says Brian Stoffers, co-president of CBRE Capital Markets, a financing and investment sales division of Los Angeles-based broker CB Richard Ellis Group. "The market's getting stronger."
—Brian Louis and David M. Levitt

The bottom line *More than half of defaulted properties have completed workouts, helping to prevent disaster in the commercial real estate market.*

Jobs Boosted Property Values in 2010



DATA: BUREAU OF LABOR STATISTICS; NATIONAL COUNCIL OF REAL ESTATE INVESTMENT FIDUCIARIES

Stocks

Sales Rebound, and Job Growth May Follow

▶ **It's not just cost-cutting powering profits now—business is picking up**

▶ **"As demand goes up, you need to have employees working"**

In a telling indication that business is strong, a greater percentage of U.S. companies is exceeding sales forecasts than at any time in the past four years, helping drive the biggest stock market rally since 1936.

Caterpillar and **United Parcel Service**, whose construction equipment and delivery businesses make them barometers for the economy, are among the 71 percent of Standard & Poor's 500-stock index companies whose revenue topped analyst estimates last quarter, the largest proportion since at least 2006, according to data compiled by Bloomberg. Sales beat projections by an average of 2.2 percent, the most in two years, the data show.

While earnings gains can result from cost-cutting (companies fired as many as 8.75 million workers from January 2008 through February 2010), the sales momentum is a sign that basic business

CLOCKWISE FROM LEFT: PETER FOLEY/BLOOMBERG; GREG WOOD/AFP/GETTY IMAGES; ILLUSTRATION BY KATE FRANCIS

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demand is strengthening and may be a prelude to increased hiring that would buttress the recovery. "Sales tend to be highly correlated to economic activity," says Greg Woodard, a strategist at Manning & Napier in Fairport, N.Y., which manages about $36 billion. "We're starting to see the very early signs of hiring."

Total revenue for S&P 500 companies may rise 7.5 percent this year, the most since 2007, to an all-time high of $1,017.44 a share, according to analyst estimates compiled by Bloomberg. Sales fell 13 percent from September 2008 to March 2009.

Caterpillar, the world's largest maker of earth-moving equipment, said it added about 19,000 jobs last year, including 7,500 positions, a 15 percent increase, in the U.S. The company, based in Peoria, Ill., beat analysts' projections for fourth-quarter sales by 11 percent, the biggest margin in almost three years. The shares gained 64 percent last year and reached an all-time high of $100.61 on Feb. 8.

"You're definitely going to see an increase in hiring in almost every industry this year," says Eric Green, a money manager at Penn Capital Management in Philadelphia, which oversees $5.6 billion. "As demand goes up, you need to have employees working."

At **Google**, executives are preparing for the biggest year in employee growth in the company's history. The owner of the world's most popular search engine, which plans to hire at least 6,000 people this year, posted revenue that beat forecasts by 5.1 percent on Jan. 21, Bloomberg data show.

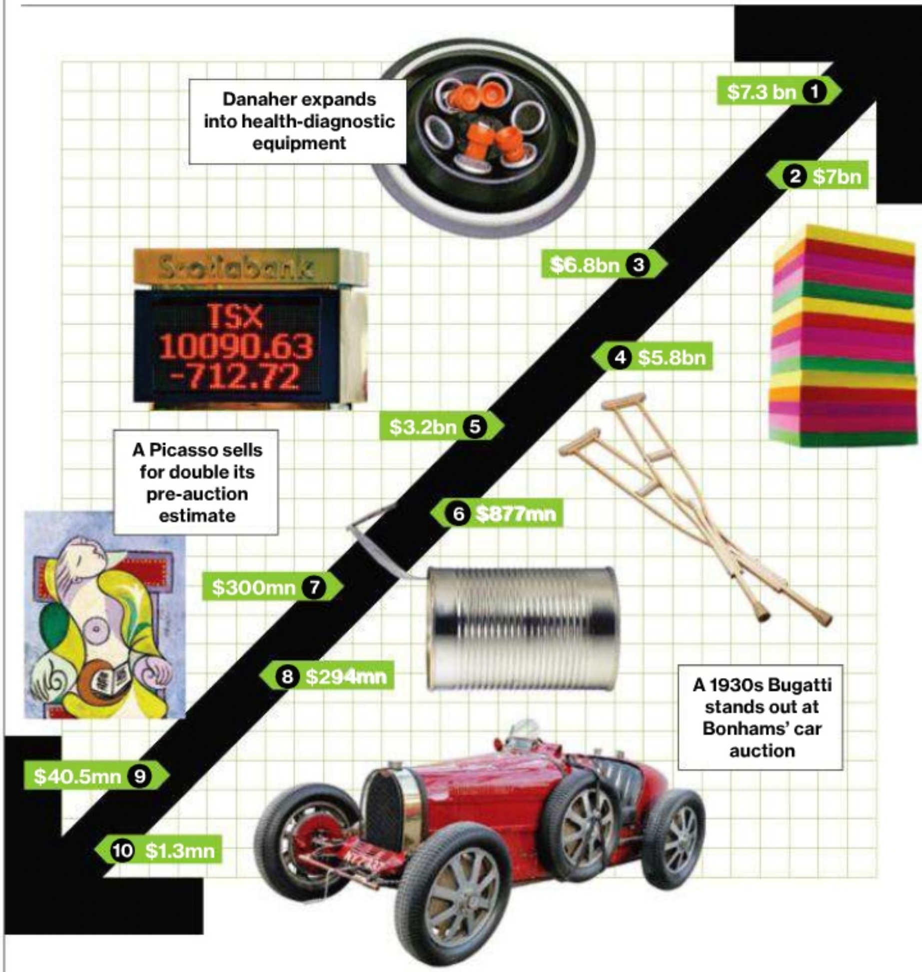
The stronger results helped the S&P 500 hit 1,324 on Feb. 8, a 31-month high. It has surged 96 percent since March 2009, the biggest advance for a comparable period since 1936, according to Howard Silverblatt, an index analyst for S&P. David Bianco, chief U.S. equity strategist at Bank of America, predicts the index will hit 1,400 by the end of the year. On Jan. 31 he wrote: "Better-than-expected sales growth means earnings growth is being driven not by cost-cutting but by improving demand." B

—*Whitney Kisling and Lynn Thomasson*

The bottom line *Sales growth is a sign the economy is reviving and may encourage companies to hire, strengthening the recovery.*

Bid & Ask

by Cristina Lindblad



1 British oil driller **Ensco** is buying U.S. rival Pride International, for $7.3 billion. The deal will give Ensco exposure to Brazil and West Africa.

2 **3M**'s board approved a stock-buyback plan of as much as $7 billion. The sum would cover about 11 percent of shares outstanding at the current price.

3 **Danaher**, a Washington-based company that sells microscopes and water-treatment systems, offered $6.8 billion for Beckman Coulter, a California maker of health-diagnostic equipment.

4 Spain's **Banco Santander** bid $5.8 billion for 100 percent of Polish lender Bank Zachodni. Santander has spent more than $10 billion on international acquisitions since June.

5 **London Stock Exchange** offered $3.2 billion for Toronto Stock Exchange owner TMX Group. NYSE Euronext and Deutsche Börse said on Feb. 9 that they too are in merger talks.

6 **Kindred Healthcare** is paying $877 million for RehabCare, creating the No. 1 provider of rehabilitation services in the U.S. with $6 billion in annual revenue and operations in 46 states.

7 Golden Gate Private Equity offered about $300 million for **Conexant Systems**, a California-maker of office printers, digital picture frames, and PC speakers, topping an earlier bid from Standard Microsystems.

8 Britain's **Premier Foods** is selling its canning business to Japan's Mitsubishi for $294 million, amid less consumption of canned foods among Britons.

9 *La Lecture*, a **Pablo Picasso** painting of one of his mistresses, sold for $40.5 million in London. Ten of the 42 lots at Sotheby's auction of Impressionist and modern art did not find buyers.

10 An English lord's 1930s **Bugatti** Grand Prix racer fetched $1.3 million, including fees, at a Paris auction of vintage cars organized by Bonhams.

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Focus On **Enterprise**

Turning Smartphones Into Cash Registers

▶ **Plug-in card readers are bringing new sales to small merchants**

▶ **"I want to make sure we look like we are a legitimate business"**

Last year, Mark Pastore wanted to expand his cured meats business, **Boccalone**, beyond the exposed-brick confines of its store in San Francisco's Ferry Building. When he began trucking salamis and sausages to farmers markets around the Bay Area on weekends, accepting credit cards was a hassle that involved entering customers' numbers manually into his cell phone. So last October he started using Square, a matchbook-size credit-card reader that plugs into his iPhone and automates the entire process. "It's like a virtual cash register," says Pastore, noting that the outdoor operation helped put his four-year-old business over $1 million in sales last year and may account for 10 percent of revenue in 2011.

Pastore is one of thousands of entrepreneurs using cheap, simple payment devices made by **Square** and at least two other companies. Smartphone card readers are being used by an Austin (Tex.) veterinarian making house calls, a sidewalk artist selling books in New York's Washington Square Park, and heating and cooling technicians in rural Ohio, who accept swipes for thousands of dollars of repairs with no paperwork.

Payments made via smartphone credit-card readers—a technology that didn't exist a few years ago—will total $11 billion this year, researcher Aite Group estimates. By 2015 such transactions could amount to $55 billion, it says. "When smartphones came on the market, it became clear that there was going to be an opportunity to connect remote salespeople with sales opportunities," says David Robertson, publisher of *The Nilson Report*, an industry publication.

Square, a Silicon Valley startup launched by **Twitter** co-founder Jack Dorsey in 2009, has helped fuel interest in mobile payments. It and similar products from **Intuit** and **Verifone** are giving entrepreneurs a range of options for turning phones into payment kiosks. For Intuit, what began as a technology aimed at tradespeople "has turned into much more of a mass market product," says Chris Hylen, general manager of the company's payments division. "It solves needs for small businesses anywhere."

Most of the products give merchants a free or inexpensive app and a card reader that plugs into a handset. Customers swipe a card and sign the touchscreen with a finger or a stylus, then get an e-mail or a text with a receipt. The services cost merchants 15¢ to 20¢ per transaction plus 2 percent to 3 percent of the sales amount and, sometimes, a small monthly fee. After the payment is processed, money is deposited in the merchant's bank account.

Intuit offers its free GoPayment card swiper to the 4 million small businesses that already use its accounting software, QuickBooks. Square, which says it's adding some 60,000 merchants a month, sends boxes of its card readers to users who agree to talk up the service. Chief Executive Officer Dorsey expects this effort to encourage Square's adoption among food trucks, taxi drivers, and other entrepreneurs who, he says, "would benefit massively from Square."

Swiping a credit card on an iPhone is bound to turn off some mobile merchants, says Nick Holland, an analyst with technology researcher



Card readers such as Square's plug into iPads, iPhones, and Android devices

Square charges merchants 2.75 percent of sales plus 15¢ per card swipe

ILLUSTRATION BY KATE FRANCIS

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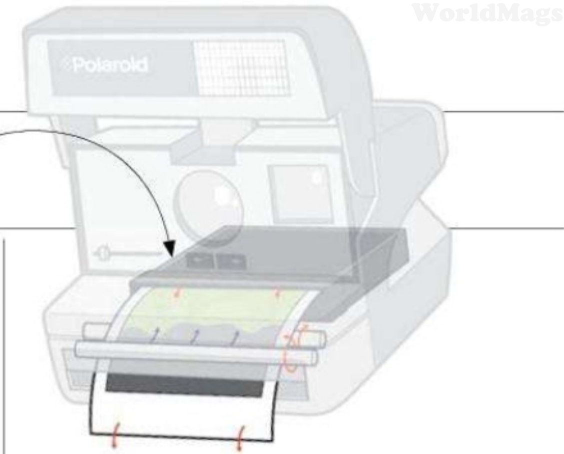
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Yankee Group. "When you have somebody whose core business is delivering pizza and they need a robust design, these aren't going to do the job," he says. Unlike devices dedicated to reading credit cards, smartphones can be used to download malicious software that could allow hackers to mine them for information, warns financial services researcher Javelin Strategy & Research. Companies that sell smartphone card readers say the risks are minimized by encryption software and other technologies ensuring that cardholder information is never stored on the phone. "We are maniacally focused on security," says Robbie Lopez, head of global payment software at **VeriFone**.

Some merchants are using the mobile options in their stores. After a power surge fried the card-processing terminal at **Remedy Coffee** in Oakland, Calif., owner Todd Spitzer discovered that a new one would cost $7,000. So he opted for Square's free card reader, which he plugs into his iPad. Square charges him 15¢ per swipe and 2.75 percent of each transaction, vs. the 20¢ plus 3.5 percent and $10 a month he was paying before. He's now using a second Square in an Airstream trailer he converted into a coffee truck that he parks outside the Berkeley Art Museum and other area attractions, and he'll have a third in a shop he's opening soon inside the museum. Spitzer hopes to triple Remedy's revenues this year, to about $1.3 million.

Many small business owners say accepting cards gives them greater credibility. "I want to make sure we look like we are a legitimate business and not some vendor that's just going to be there for the moment," says Doug Ipock, owner of **Fusion Sports**, which sells athletic apparel from a truck at amateur lacrosse, soccer, and other sports tournaments in North Carolina. Since Ipock began accepting credit cards using Intuit's GoPayment service in addition to cash, he says more coaches and school athletic directors have made repeat orders by phone or via his website.

At least for now, merchants say, they also benefit from the cool factor. At 2 a.m., after last call in Portland, Ore., bar patrons in the hip Old Town neighborhood line up at **Big-Ass Sandwiches**, a food truck. Lately, customers have been as intrigued by the Square device used to swipe their credit cards as by the eclectic menu. Some even make return visits just to show friends, says Lisa Wood, who runs the truck with her husband, Brian. "It becomes this whole spectacle." *—Douglas MacMillan*

***The bottom line** Card readers that plug into smartphones let even the smallest businesses accept credit cards, at a cost of about 3 percent of sales.*

Technology

An Analog Photo Fix For the Digital Age

▶ Austrian startup Impossible is on a mission to revive instant film

▶ "Companies pay millions to build that kind of consumer interest"

Under the tutelage of its creative director, Lady Gaga, instant-photo pioneer **Polaroid** has introduced a slew of futuristic products such as sunglasses that shoot video. One thing Polaroid doesn't offer is film for its vintage cameras. The company in 2008 sold that business to an Austrian startup called the **Impossible Project**.

Since then, Impossible has shown that instant film has a future, even in the Digital Age. The company has introduced new film and has opened stores in Vienna, New York, and Tokyo, sharply boosting sales and profits. This year Impossible expects to expand its film lineup. And with no one currently making cameras that use the old Polaroid format, the company plans to launch its own instant model in 2012. Florian Kaps, one of three founders, says the company's success lies in preserving the soft, distorted colors of vintage Polaroid film. "Because of the digital revolution, people are starting to go in the opposite direction, toward retro analog products, and the fun is just beginning," Kaps says.

Polaroid's instant-film business started to fade to black in the mid-2000s. Sales declined nearly 25 percent annually for several years and suppliers of essential chemicals planned to exit the field because of environmental concerns and bleak revenue prospects. Just two days before the company was to shutter its last instant-film factory, in the Dutch city of Enschede, and destroy millions of dollars' worth of unique equipment, Kaps stepped in.

He teamed up with André Bosman, a manager at the factory, to offer $3.1 million for Polaroid's machines, inventory of some 400,000 packs of film, and a 10-year lease on the facility. They brought Austrian entrepreneur Marwan Saba on board to help raise funds, and



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Making a market from infidelity page 60 ▶

Acquisitions

When It's Time to Cash Out

Deals are bouncing back among buyers and sellers of Main Street businesses. Last year transactions climbed 3 percent, vs. a 28 percent drop in 2009. Prices, however, continued to fall. —*Nick Leiber*

Average sale price as a percentage of asking price, 2010



Where buyers pay the most for small businesses*

Metropolitan area	Median business sale price	% change from 2009
Salt Lake City	$425,000	24%
Detroit	$399,000	68%
Pittsburgh	$350,000	−1%
Contra Costa, Calif.	$230,000	0%
Indianapolis	$230,000	−49%
New Jersey	$225,000	11%
Washington, D.C.	$215,000	21%
New York	$210,000	19%
San Francisco	$200,000	−25%
Philadelphia	$200,000	−38%
Charlotte, N.C.	$198,000	9%
Cincinnati	$197,000	9%
Portland, Ore.	$188,000	15%
Raleigh, N.C.	$185,000	34%
Dallas	$185,000	−1%

*METRO AREAS WITH AT LEAST 10 REPORTED TRANSACTIONS. DATA: PRIVATE COMPANY SALES FROM 2007 THROUGH 2010 REPORTED TO ONLINE MARKETPLACE BIZBUYSELL.COM

the team quickly found a dozen backers willing to invest in the venture. Given Polaroid's loyal customer base, "it would have been pretty difficult to miss the opportunity," Saba says. "Companies pay millions to build that kind of consumer interest."

Problem was, four factories integral to the production of Polaroid's film had already closed. This was resolved by entering into a partnership with **Ilford** and other photographic-equipment companies to get components such as paper and coatings. A more serious challenge was replacing chemicals long used in Polaroid's formula (hence the name Impossible Project). Kaps and his team hired former Polaroid engineers to develop recipes that use readily available ingredients without sacrificing Polaroid's analog charm.

The old Polaroid factory in Enschede, a vast facility that once employed 1,200, gives the 36 Impossible staffers who work there plenty of room to run with their ideas. Impossible has already developed two sepia-toned films and an experimental color version. This year it plans to release an 8x10 format as well as a new color formula.

At Impossible's Manhattan store, an airy loft five stories above Chinatown's busy streets, instant-film devotees ride the rickety elevator to check out the wares. The store, which has the look and feel of a SoHo art gallery, offers film as well as old Polaroid cameras that the startup refurbishes. "We're buying cameras furiously," says Impossible America Vice-President David Bias. "I have about 10 guys scattered around the country scavenging them for me at flea markets and yard sales."

The company says it pulled in a profit of $270,000 on revenues of $4 million in 2010. This year Saba expects Impossible to triple revenues and quadruple profit, selling 2 million eight-frame packages that retail for about $22. "There's a baseline potential for selling 10 million film packs [annually]," he says.

Kaps and his team have been able to turn a profit where Polaroid struggled because Impossible is so much smaller and its fixed costs are lower, says Chris Chute, a digital imaging analyst for researcher IDC. Polaroid's "production was coming out of these huge facilities, and once volume started to dip, the economies of scale worked against them," he says. Impossible's advantage is that "there are so many Polaroid cameras out there and the one thing that's missing is film."

Impossible isn't the only player in the market. Fujifilm has long made instant film and cameras, though its products aren't compatible with the classic Polaroid cameras. Fuji offers "the best image and best color reproduction in the photographic market," says Kayce Baker, the company's marketing director.

Polaroid, under new ownership since 2009, has also gotten back into instant film. Last April the company started reselling a Fuji instant camera and film packets under its own brand. Polaroid President Scott W. Hardy says he was impressed with Fuji's global distribution



Impossible has 36 workers at a Dutch plant that once housed 1,200

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and image quality. The former pioneer is working on a camera that marries digital and instant photography, as well as filters that let customers choose the look of their instant products. "There's definitely a need for the artsy, surprise-me-with-how-it-develops film," Hardy says. "But for the mass market... there's a much higher standard in terms of the photographic quality."

Kaps isn't worried about the competition. He predicts that Impossible will prosper by catering to shutterbugs who love the imperfections of the original Polaroid. "The big advantage Fuji once had–which is the big disadvantage now–is that it's a far better quality product, so it almost looks like digital," he says. As for Polaroid's efforts to resell Fuji cameras and film, "It's as if Coca-Cola no longer had the recipe for its drink and just decided to put Pepsi into their bottles." —*Caroline Winter*

The bottom line *After buying Polaroid's last film factory, the Impossible Project is making a profit where the instant-photo pioneer saw little future.*

Competitions

Business Plan Contests: Where Are the Women?

▶ Many groups are trying to increase female participation

▶ "You have to be ready to toot your own horn"

Something bothered Jane Pak when she served as a judge for a regional competition of the Global Student Entrepreneur Awards (GSEA) at the University of Southern California last summer: All the contestants were male. "Where are the girls?" she asked the two other female judges. "It was so obvious to us that this was a problem," says Pak, chief executive officer of the Los Angeles chapter of the National Association of Women Business Owners. "No one else seemed to notice."

Women often go missing from the 100-plus entrepreneurial competitions held annually in the U.S., where winners take home prizes ranging from cash and trophies to contacts that can lead to opportunities. In the GSEA's 2010 contest, just 25 of the 145 competitors were women and the winners and runners-up were all male. Since 2007 only 13 percent of the event's 117 finalists have been female. The scant presence of women in such events "makes me want to put my head down and weep," says J. Janelle Shubert, director of the Center for Women's Leadership at Babson College.

While no formal statistics are kept, several people connected with business plan and entrepreneurship competitions say women represent at most 20 percent of entrants. That's even though they launch 40 percent of all private companies, according to the Kauffman Foundation, which promotes entrepreneurship. "Fewer women are still finding their way into spearheading their own idea," says Sara Gragnolati, 33, the first solo woman to win the top prize in Babson's MBA business

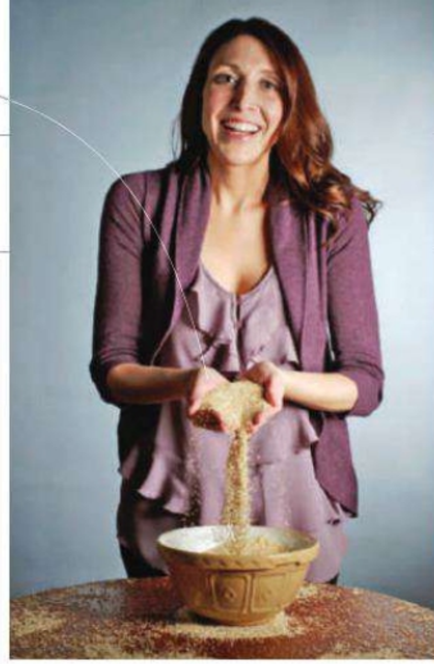


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Gragnolati's cereal company was a winner



GRAGNOLATI: PHOTOGRAPH BY JOHN GOODMAN FOR BLOOMBERG BUSINESSWEEK

plan contest, launched more than two decades ago. She took home $20,000 for her company, **Cocomama Foods**, which sells gluten-free breakfast cereals. "I felt kind of honored," Gragnolati says, "but I found it surprising and sad" that it had taken so long for a woman to win.

Experts in entrepreneurship—both women and men—say a lack of confidence and bluster, an aversion to risk, and a continued scarcity of women in engineering programs may explain the shortage. Pak believes the problem starts in childhood. "Even the most progressive parents don't assume their daughters are going to be primary breadwinners," she says. Babson's Shubert says women are less likely to belong to organizations that sponsor contests. Although more than half of graduate students are female, women "are not driving to positions of influence," says Sharon Vosmek, CEO of Astia, a nonprofit that supports women-owned companies. "You have to be ready to toot your own horn in a way that we're not seeing women doing."

More practical considerations may also contribute. Elif Hanna, an MBA student at the University of California, Irvine, was the only mother to enter her school's annual business plan competition. "It was very hard for me to participate," she says. "Most of the meetings were after seven." Rejected in the first round, Hanna started an online wedding invitations company, funding it herself.

Efforts are under way to boost participation by women. **Ernst & Young** set up its annual Entrepreneurial Winning Women contest in 2008 to strengthen promising female-led businesses by connecting them with potential partners and investors. This year, Kauffman Foundation and Astia are sponsoring the first Women in Science and Engineering Business Idea Competition.

Tech networking group Women 2.0 says its annual pitchfest—in which teams presenting ideas to potential investors must include at least one woman—is attracting more venture capitalists. A 2010 participant pitched technology that lets immigrants send money home via mobile phones, says Women 2.0 CEO Shaherose Charania. It's "something that a Sand Hill Road [VC] guy is never going to use," she says, "but it solves a real problem instead of just making rich peoples' lives more cushy." B

—*Karen E. Klein*

The bottom line *Few women entrepreneurs participate in business plan contests. Now many groups are trying to boost their numbers.*

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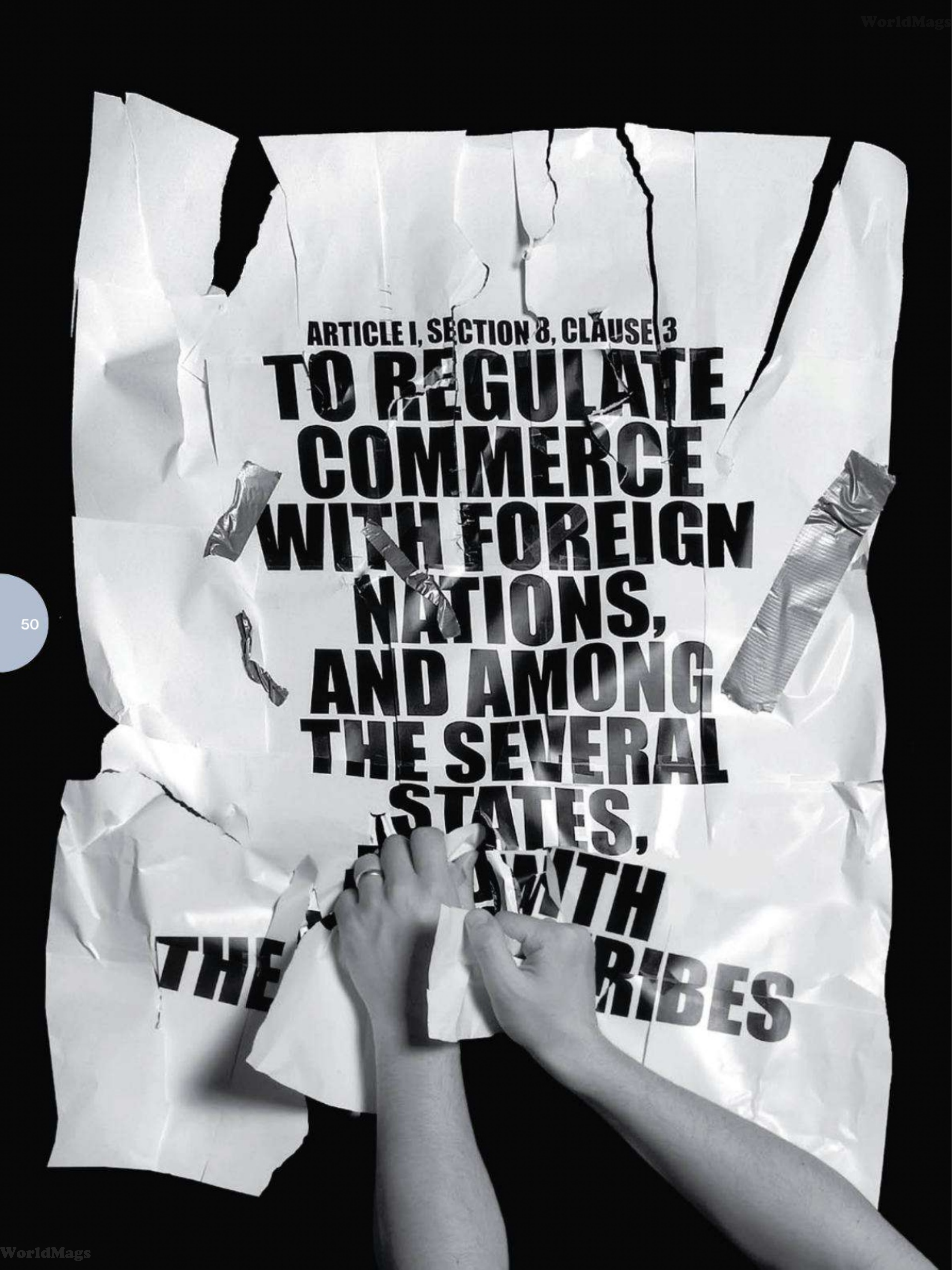
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A new assault on regulation is gathering force—and it's deploying a Constitutional weapon

By Paul M. Barrett

The Commerce Claws

On the afternoon of Jan. 31, Richard A. Epstein was in his office at New York University Law School when a request came in from a conservative website called Ricochet.com. A federal district court judge in Florida had just struck down the Obama Administration's health-care overhaul, and the site wanted Epstein's reaction. Judge Roger Vinson had ruled that in passing the bill last year, Congress exceeded the authority granted it by the so-called Commerce Clause: Article I, Section 8, Clause 3 of the U.S. Constitution, which allows lawmakers "to regulate Commerce ... among the several states." For Epstein, 67, a voluble and prolific scholar who for four decades has been arming conservatives with intellectual weaponry to attack regulation, it was an I-told-you-so moment. "The Commerce Clause challenge to Obamacare indeed has legs," he blogged. "The government played table stakes poker, and for the moment it has lost."

A central figure at the University of Chicago until he moved to NYU last year, Epstein has written over the years about a dizzying array of legal issues: zoning, banking, and job discrimination; product liability, patents, and pharmaceuticals; the environment, workers' comp, and taxation. Unifying his scholarship is a persistent theme: Government stifles capitalist ingenuity and generally screws things up. "It's amazingly consistent that way," he says amiably, ringed by a mountain range of papers in his Greenwich Village office.

The legal fight over health-care reform is likely to end up before the U.S. Supreme Court just in time for the 2012 Presidential race. (Federal appeals courts will have their say in coming months, making the issue a strong candidate for the justices' election-year docket.) Even with his cause riding high, though, Epstein isn't getting carried away with optimism. The high court lost its way on the topic of regulation back in the 1930s, he says. "We've been on the wrong track ever since."

For its first 150 years, the Supreme Court interpreted "among the several states" to mean that legislators could set rules only for trade that crossed state lines–via railroad, for example–and not for manufacturing, farming, or other business conducted exclusively within a state. In the face of the Great Depression's economic devastation and relentless political pressure from President Franklin D. Roosevelt, however, the court drastically shifted its understanding of the Commerce Clause (along with its view of a number of other parts of the Constitution). By 1942, in the landmark case of *Wickard v. Filburn*, the court upheld federal regulation of a farmer who grew wheat strictly for his own consumption. In a modern economy, the court reasoned, even subsistence crops affect demand in the national marketplace.

Does the logic of *Wickard v. Filburn* cover President Barack Obama's plan for health care, an industry responsible for 17 percent of the nation's gross domestic product? It's a dandy law school exam question. It's also the most important inquiry about the interplay of government and business percolating in the U.S. legal system. Two Republican-appointed federal judges–the one in Florida and another in Virginia–have answered "no," ruling that Congress exceeded its Commerce Clause authority when it imposed a requirement last year that all American adults obtain health insurance. Two Democratic judicial appointees–one in Michigan, another in Virginia–have disagreed, upholding the statute. When the battle reaches the high court, the fate of near-universal health care may hang on the swing vote of a single justice.

The legal fight over health care is likely to end up before the Supreme Court in time for the 2012 election

Take a step back, though, "and there's a much bigger fight here that goes way beyond health insurance," says Eric Lane, a liberal constitutional scholar at Hofstra Law School. It's a new assault on regulation being led by the ascendant Republican majority in the House of Representatives. Party leaders vow to use committee hearings and floor debates to make 2011 a year of misery for executive branch regulators. In Congress and the courts alike, skirmishes are under way over the Environmental Protection Agency's authority to limit greenhouse gas emissions and the legitimacy of last year's Wall Street reform legislation. And conservative legal tacticians who have rolled back government limits on campaign spending and gun ownership are seeking to extend those victories. Perhaps Professor Epstein should be in a more hopeful mood.

At the highest levels of the U.S. ju-

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Now at NYU Law School, Epstein has been calling for limited government for 40 years

diciary, there have always been jurists who sought to revisit America's long-settled understanding of the proper extent of congressional authority over economic affairs. The late Justice William H. Rehnquist kept the flame alive in a series of solo dissents in the 1970s and '80s, earning him the nickname "the Lone Ranger" before his elevation to Chief Justice in 1986 inclined him more toward cooperation. That year, President Ronald Reagan's Attorney General, Edwin Meese III, invited Epstein to make a presentation on the Commerce Clause at the Justice Dept. "The Reagan people knew me from *Takings*," Epstein explains, referring to a book he published in 1985 that laid out a controversial theory of the Fifth Amendment's Takings Clause. That clause states that private property can't be "taken for public use, without just compensation." Epstein maintains that any regulation reducing the value of private property—such as zoning—requires compensation of the owner.

Epstein's research on the Commerce Clause produced an article published in 1987 in the *Virginia Law Review*. "The idea that Congress can restrict pretty much any economic activity that has a 'substantial effect' on commerce—which the Supreme Court announced in 1942 in *Wickard*—was always wrong," Epstein says, summarizing his findings. "I'd say it was a giant fraud, and it has stifled economic liberty ever since."

He remains in a distinct minority on this point. Most constitutional scholars—and judges—see the expansion of federal power as a natural outgrowth of the vastly increased complexity of the American economy brought on by industrialization, modern transportation, and improvements in communication. "Congress's power to regulate 'interstate commerce' became, in effect, the power to regulate 'commerce' generally," David D. Cole, a liberal law professor at Georgetown University, wrote late last month in *The New York Review of Books*. "The court rejected as empty formalisms the distinctions it had previously drawn between local and interstate, between production and commerce, and between 'direct' and 'indirect' effects."

Despite a concerted program of issue-oriented litigation and conservative judicial appointments—one supported by the Federalist Society, a private network of right-leaning lawyers and scholars—the Reagan Administration had little success pushing Epstein's views in court. In 1995, Douglas H. Ginsburg, a Reagan appointee on the federal appeals court in Washington, publicly mourned what he called "the Constitution-in-exile": provisions such as the Commerce, Takings, and Contract Clauses, which he argued had been unwisely marginalized by the Supreme Court. "The memory of these ancient exiles, banished for standing in opposition to unlimited government," Ginsburg wrote in the journal *Regulation*, "is kept alive by a few scholars who labor on in the hope of a restoration, a second coming of the Constitution of liberty—even if perhaps not in their own lifetimes."

Although the second coming has not occurred, the debate continues. In 1995 the Supreme Court struck down an obscure federal law prohibiting possession of a gun near a school. Without disturbing any precedent, Rehnquist wrote in *U.S. v. Lopez* that, under any definition, the mere possession of a firearm in a local school did not affect interstate commerce. The decision had little practical consequence, since gun infractions near schools were still covered by state laws. Still, *Lopez* caused a stir in legal circles because it marked the first time since the New Deal that the high court said the Commerce Clause did not accommodate something Congress wanted to do.

"The Commerce Clause challenge to Obamacare indeed has legs," Epstein blogged on Jan. 31

Justice Clarence Thomas, who sided with the *Lopez* majority, identified himself as the inheritor of Rehnquist's Lone Ranger hat. In a separate concurrence that echoed Epstein's 1987 *Virginia Law Review* article, Thomas wrote that the Supreme Court erred when it departed in the 1930s from 19th century legal doctrines that strictly limited federal regulatory power. In an open-ended invitation to litigants, Thomas wrote: "In a future case, we ought to temper our Commerce Clause jurisprudence in a manner that both makes sense of our more recent case law and is more faithful to the original understanding of that clause."

"What Justice Thomas was getting at—more aggressively than anyone else—was that the actual words of the Constitution don't say Congress can do whatever it wants in regulating the economy," says John Yoo, a constitutional law professor at the University of California at Berkeley. As a newly minted lawyer, Yoo was clerking for Thomas when *Lopez* was decided. "If the court wanted to get back to what the founders had in mind about commerce," he adds, "the text and history of the Constitution would support a big change in the doctrine." Thomas's presence on the country's top tribunal makes it more plausible for business interests and conservatives to argue in lower courts that one or another regulation deserves to be struck down.

Cass R. Sunstein, a Harvard law professor on leave while he runs Obama's Office of Information and Regulatory Affairs, takes the Thomas invitation seriously. In 2004 he warned about the return of what he called "Herbert Hoover's Constitution"—a liberal's derisive spin on Ginsburg's Constitution-in-exile. Under the Hoover Constitution, Sunstein wrote in *Washington Monthly*, "the powers of the national government were sharply limited." He accurately predicted that if fortified by second-term appointments by President George W. Bush, the Supreme Court might read the Second Amendment expansively to curb federal and state gun control laws. Led by Bush-nominated

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Rivkin represents a coalition of 26 states challenging the health-care bill in Florida

Chief Justice John G. Roberts, the court in 2008, and again last year, struck down firearm restrictions in Washington, D.C., and Chicago, declaring clearly for the first time an individual right to keep a handgun. Sunstein was also prescient in saying that a conservative majority might curtail campaign-finance regulation, as it did in 2010 in a ruling strengthening the First Amendment speech rights of corporate interests. On yet another front, Sunstein envisaged an assault on environmental regulations. That offensive is well under way as Texas spearheads litigation intended to hobble the EPA's ability to regulate carbon emissions.

The Hoover Constitution isn't likely to be restored in full, Sunstein acknowledged. "But don't be surprised if you see significant movement in its direction." A spokesman for Sunstein declined to comment.

The Supreme Court's more recent Commerce Clause pronouncements leave the fate of the health insurance mandate an open question. In 2000 the court said Congress exceeded its authority when it passed a law giving victims of gender-motivated violence a basis for suing attackers in federal court. Regardless of good intentions, the statute did not concern commerce, the majority concluded. Leaning in the opposite direction, the court ruled in 2005 that Congress could criminalize homegrown marijuana, even for medicinal use. "If the majority is to be taken seriously," Thomas wrote in dissent, "the federal government may now regulate quilting bees, clothes drives, and potluck suppers throughout the 50 states."

Federal regulation of quilting bees isn't being litigated, but Obama's attempt to create a health insurance system covering all Americans surely is. David B. Rivkin Jr., a lawyer who served in the Reagan and George H.W. Bush administrations, has been bothered by the idea of mandated insurance for nearly two decades. In 1993 he took to the op-ed page of *The Wall Street Journal* to argue that Clinton Administration proposals for universal participation in a national health system would "draw the curtain on the Constitution of 1787," confirming "that there is nothing that Congress cannot do under the Commerce Clause." In the 1990s, as Rivkin noted, some Republicans in Congress also supported the idea of requiring everyone to participate in the health system, so that costs would be spread across the entire population. The issue became moot when Clinton-era health reform died on Capitol Hill.

When Obama revived the campaign for comprehensive health coverage in 2009, Rivkin returned to the ramparts, arguing its unconstitutionality in the *Journal* and venues sponsored by the Federalist Society. He also provided legal advice to GOP state officials skeptical of the Obama plan. The counseling grew into a paid post at Baker Hostetler, the corporate law firm in whose Washington office Rivkin is a partner. He and a team of colleagues represent a coalition of 26 states challenging the health-care bill in Florida.

Born in 1956 in a small village in the former Soviet Union, Rivkin brings an immigrant's patriotic zeal to defending his vision of the U.S. Constitution. A classical bust of George Washington greets a visitor to his office. With characteristic zest, he declares that "the Obama health reform law is the most profoundly unconstitutional statute in U.S. history." At the same time, he insists, he is not trying to alter Supreme Court jurisprudence. Instead, he says the justices have always assumed that the Commerce Clause authorizes regulation of economic "activity." The health insurance mandate, Rivkin contends, is unconstitutional because it regulates "inactivity"—namely, individuals' decision not to buy insurance. "Inactivity cannot be regulated under the Commerce Clause," he argued before U.S. District Judge Vinson in Pensacola, Fla., on Dec. 16. Vinson agreed, and the activity/inactivity distinction became central to his ruling.

Rivkin contends that the insurance mandate is unconstitutional because it regulates "inactivity"

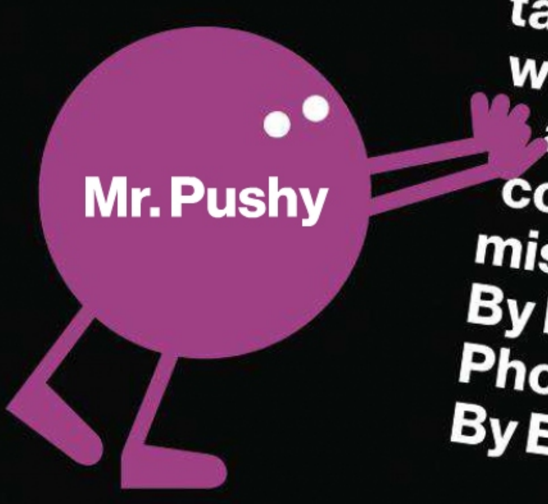
The Obama Administration has called mandatory coverage the health plan's financial linchpin because without it, some people would refrain from acquiring insurance until they get sick, driving up costs. Ian H. Gershengorn, the senior Justice Dept. attorney defending health reform in the courts, told Judge Vinson in oral argument that those who don't buy health insurance are making an economic decision to pay later or shift the cost to others. Everyone, at some point, takes part in the health-care market. "The uninsured are not inactive," Gershengorn argued. Striking down the overhaul would amount to "a return to the 1930s," he said.

Judge Vinson didn't buy it. He said that he wasn't deciding on the wisdom of health reform, but on a more abstract principle. "If Congress can penalize a passive individual for failing to engage in commerce, the enumeration of powers in the Constitution would have been in vain for it would be difficult to perceive any limitation on federal power," he wrote in his 78-page Jan. 31 ruling. "We would have a Constitution in name only."

Epstein has nothing but admiration for Vinson's bold move. Like some other Supreme Court watchers, he expects a 5-4 resolution, with the conservative but sometimes unpredictable Justice Anthony M. Kennedy casting the deciding vote. If pressed, Epstein forecasts that Kennedy will vote to uphold the legislation "on the ground that the mandate is but one part of a comprehensive health-care whole, so that the mandate has to be judged, to borrow from John Donne, not as an island, but as a piece of the main." On the other hand, he adds, maybe Kennedy will pleasantly surprise him and turn the court in Epstein's direction. Says the professor: "I have been wrong before." Ⓑ

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Bill Ackman is an open, friendly, talkative guy who makes a lot of companies miserable.

By Devin Leonard

Photographs By Ethan Hill

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On Tuesday mornings, William Ackman, the founder and CEO of Pershing Square Capital Management, holds an investment meeting at his office overlooking Central Park in Manhattan. It was at one of these sessions several years ago that Ali Namvar, a senior analyst at his firm, brought up a company that interested his boss. It was called Fortune Brands.

As Namvar described it to Ackman, Fortune Brands was a corporate platypus. At the heart of the Deerfield (Ill.) operation was a spirits division with bourbons such as Jim Beam, Maker's Mark, and Knob Creek. It also had a golf division that sold Titleist putters and drivers. And a "home and security" unit that made Moen faucets and Master Lock padlocks. This combination didn't make sense to Ackman or to anybody else in the room.

Afterward, Ackman read several of the company's annual reports and concluded that this old-fashioned and, more importantly, undervalued conglomerate was a piggy bank in need of a hammer. "We didn't think it was a logical structure," Ackman says. "The question was: When does it makes sense for these to become separate companies?" This was hardly an academic issue. Ackman's hedge fund has $9 billion under management, and he likes to take large positions in companies and agitate, sometimes publicly, for them to adopt his suggestions. He rarely gives up. "He is the most relentlessly stubborn person on the planet," says his friend Whitney Tilson, managing director of T2 Partners, another hedge fund.

Ackman, 44, isn't shy about taking his case to the media, either, if he feels he isn't getting the proper amount of attention. At 6 feet, 3 inches tall and with prematurely gray hair, he looks rather like a congressman. What really frustrates managers of his target companies is how charmingly he goes about his business, which makes it hard for them to paint him as a crank and brush him off.

Ackman waited quietly for five years. In October 2010, with Fortune's share price suffering from the collapse in the housing market, he bought 11 percent of the company's stock. Shortly thereafter, he placed a call to Fortune Brands Chief Executive Officer Bruce Carbonari. "We have some ideas," Ackman told him. "We'd love to meet you."

Ackman is mobbed at investor conferences. Bloggers pore over his investor letters when they appear on the Internet. Ackman denies posting them, but he seems to relish the publicity, which distinguishes him from many others in this secretive business. What some might see as an intrusion, he regards as a useful transparency. Along those lines, Ackman seems to be styling himself as the people's hedge fund manager. In March 2009, in a bid to become one of President Barack Obama's unofficial policy advisers such as BlackRock's Larry Fink or Pimco's Bill Gross, he drew up a plan to rescue the country's banks after the financial crisis and offered it to Obama. Nothing came of it, but he was welcomed to the White House by then-National Economic Council director Larry Summers, who respectfully heard him out. "They certainly listened," Ackman says. The White House declined to comment.

As far back as April 2007, Ackman had been telling anyone who would listen that the mortgage market was in trouble; in the end, the crisis was good for him. Pershing Square shorted some of the subprime industry's major players—including mortgage guarantors Freddie Mac and Fannie Mae and bond insurers such as MBIA and Ambac—and made billions of dollars. More recently, Ackman helped rescue General Growth Properties, the nation's second-largest mall owner, from near-collapse. The salvage effort contributed to his flagship fund's net return of 29 percent in 2010. According to Hedge Fund Research, the industry average was 10 percent. "We like to find investments where our interests are aligned with what's good for America," Ackman says.

He has made more good calls than bad, but the bad ones have been memorable. He ended up liquidating Gotham Partners, his first fund, in 2003, because of a bad bet on golf courses. In 2009 he apologized to clients who had money in a Pershing Square fund that suffered a $1.8 billion loss on an investment in Target, the Minneapolis-based retailer. And he admits that Pershing Square has lost $125 million on its investment in the Ann Arbor (Mich.)-based Borders bookstore chain, which is expected to file soon for bankruptcy.

In many ways he is a descendant of Carl Icahn, the corporate raider who became known in the Eighties as a greenmailer, taking stakes in companies and being such a pest that they paid him to go away. Icahn has since transformed himself into a "shareholder activist," but he still has the whiff of a fast-buck artist. Although Ackman's approach is often the same, he has managed to wrap his tactics in a smooth, well-learned politesse. "He comes across as cool and detached," says Charles Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "Those fellows from the Eighties were more theatrical."

Ackman grew up in leafy Chappaqua, the wealthy suburb of New York, and has the wonky air of a Silicon Valley or Washington type. He likes to talk about how he immerses himself in documents like Securities and Exchange Commission filings, crafting proposals so substantial that they are embraced by his targets. Indeed, Ackman calls any attempt to compare his investing style with Icahn's "absurd."

The hedge fund manager's boosters say Ackman's intellectual, constructive approach sets him apart from his old-school predecessor. "He doesn't extract value, he adds it," insists Byron Wien, chairman of Blackstone Advisory Services. "Well, he does extract it. But he adds it first."

CEOs and boards of directors, some of whom may not be eager to, say, have their empire divided into thirds, have found that hardball can follow spurned proposals. Target discovered this in 2008 when it rejected Ackman's suggestion to spin off the land beneath its stores as a publicly traded real estate investment trust. The hedge fund manager and four allies tried and failed to win seats on the Target board in a bitter and highly publicized proxy battle.

It may be that no companies really welcome carefully thought-out proposals from New York money managers. Icahn, for one, doesn't think they do. "I really think activism is good for the country," he says. "But it's absurd to believe that entrenched management and boards welcome activists when they first come on the scene. It would be like Julius Caesar thinking that the people in the provinces welcomed him into their cities because they loved him. That's how you lose money."

It's a sunny day in January, and Ackman is sitting in his conference room in Manhattan, the snow-covered park spread

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Bruce Carbonari, CEO of Fortune Brands, at headquarters in Deerfield, Ill., a few weeks after announcing the breakup plan of the company

out below, wearing the typical financier's blue shirt and red tie. Most financial types make sure they always have a PR guard of some kind around, but no one shadows Ackman, and he answers his own e-mails.

In conversation he possesses the geeky intensity of a high school wunderkind, speaking quickly as if he's trying to squeeze as much information as he can into a limited amount of time. Much of his talk these days revolves around his optimism about the recovery and how it has driven some of his investing. "We have been more bullish than most people on the economy for a while now," says Ackman.

He still sees some obstacles: the national debt, the trade imbalance, unrestrained heath-care costs, state insolvencies, and municipal credit issues. "You know," he jokes, "all the things you read about in [*Bloomberg*] *Businessweek*."

Ackman argues that these should not obscure the bright spots. Automobile sales are up. Retail sales are improving. "The world is getting better–especially the U.S.," he says. "That's good for us because we are a very U.S.-centric fund."

He adds: "The only thing that we haven't seen is an uptick in housing prices. But that will come, too."

Ackman recently gave a presentation at an investor conference titled "How to Make a Fortune" about what he sees as the coming resurgence of the housing market. "I thought it would help," the hedge fund manager says. "I thought it might encourage the marginal buyer to buy a home. That's good for the country. Actually, I got a lot of calls from people who are buying homes and starting funds to invest in rental properties as a result."

Ackman may or may not be sparking the rebound of the housing market, but he has few doubts about his thesis: He says it's all about being able to look at the world with complete dispassion. "When you go through something like the financial crisis, it makes a psychological imprint on you," he says. "It becomes hard to interpret information in a way that is positive. I'm emotionally very neutral about economic things. That's why I can look at them objectively."

He has shown such confidence for years. When Ackman was a senior in high school, he made a $2,000 wager with his father, a commercial mortgage broker, that he would get a perfect score on his SATs. He got one question wrong. But he didn't lose any money. He was so sure of himself that his dad withdrew his bet the night before the test.

Ackman went to Harvard, where he surprised his undergraduate friends with his fascination with the financial markets. "He was always interested in business and investing," says Tilson. "I still remember seeing him on Black Monday in 1987. He said, 'Did you see what happened in the market today?' I had no idea."

In 1992, after graduating from Harvard with an MBA, he and David Berkowitz, one of his classmates, founded Gotham Partners. From the beginning, Ackman fancied himself a real estate expert like his dad, and that was where a good deal of the fund's money flowed. However, real estate would also be the downfall of Gotham Partners. The fund bought 26 golf courses with other people's money and tried to sell them to a REIT. One of the trust's investors filed a class action in protest, and a New York judge effectively killed the plan in 2002. Rather than carry on, the partners dissolved the fund.

It was a painful moment for Ackman. A year earlier he had shorted MBIA, a bond insurance company that he thought was taking on too much risk by guaranteeing faddishly exotic flavors of debt such as collateralized debt obligations. He cornered regulators and ratings agency officials at public events and told them MBIA would soon fail. The bond insurer complained to then-New York State Attorney General

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Eliot Spitzer. Ackman was served with a subpoena from Spitzer's office, which wanted to know if he was spreading misinformation about MBIA to salvage his dying fund. When *The New York Times* learned of this, it painted Ackman as a sleazy opportunist.

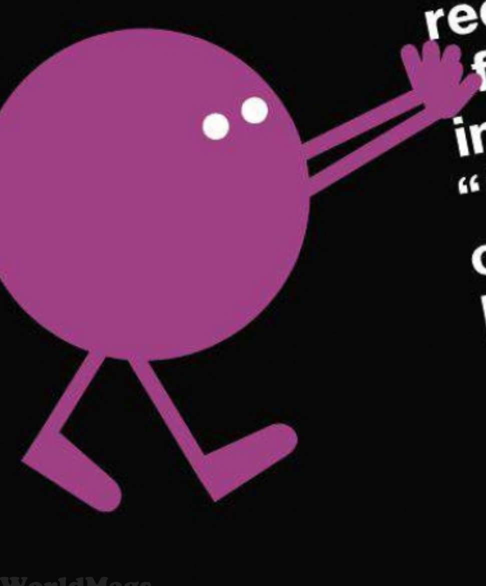
Ackman, however, was excited. He would be able to lay out his case to the authorities. "This is going to be a good thing," he told his friends. "I'm going to meet Eliot Spitzer." He sat though five days of depositions, ignoring his own lawyer at times when the guy tried to shut him up for his own good.

He reentered the hedge fund business by founding Pershing Square in 2003 and taking a new short position against MBIA, purchasing credit default swaps that would rise in price if his predictions came true. The bond insurer continued to depict him as an avaricious short-seller, and Wall Street seemed to agree. MBIA's stock went up, not down. Some of Ackman's own advisers started to worry. "Several of us got queasy and said, 'This has been going on for so long. Nobody accepts our point of view,'" recalls Edward Meyer, the former CEO of Grey Global Group. "Bill would say, 'Right is right. It will work out because I am right.'"

Ackman was vindicated in epic fashion. The Attorney General's office ended up going after MBIA instead of Ackman, and in 2007 the company paid $75,000 to settle the Attorney General's charge that it had engaged in questionable accounting practices. As billions of dollars of CDOs metastasized into toxic waste, MBIA's stock was clobbered. Pershing Square ended the year up 22 percent. "For five years he was wrong, wrong, wrong," says Tilson. "Then he made billions."

Ackman was now a hero, the hedge fund manager who tried to alert complacent Wall Street analysts, ratings agencies, and regulators about a dangerous flaw in the mortgage system. "He may be aggressive, he may be over the top, he may not be able to speak in short sentences," Joe Nocera of *The New York Times* gushed in his column, "but he's doing the hard work, and thinking the hard thoughts, that they refused to do for far too long." (MBIA declined to comment.)

"Bill would say, 'Right is right,'" recalls one friend and investor. "'It will work out because I am right'"



As Ackman was winding down his battle with the bond insurer, he started buying shares of Target. The company couldn't have been more different from MBIA. It was a well-managed retailer, the only discounter that had found an effective strategy for competing with Wal-Mart Stores. Ackman, however, had identified a problem: Target owned its own credit-card receivables. He was convinced they would be a liability at a time when people were losing their jobs. Ackman accumulated 9 percent of the company's stock. He was so confident that he parked all his holdings in one fund, juicing them up with borrowed money.

Target ended up selling 47 percent of those receivables to JPMorgan Chase. "That's something that pleased investors," says Bill Dreher, a retail analyst at Deutsche Bank. "I don't think it would have happened without Ackman's help." Even so, Target's shares fell like every other retailer's, because of the recession. By early 2009, Pershing Square's Target fund had lost 90 percent of its value, and Ackman sent an apology letter to his investors.

Predictably, perhaps, his relationship with Target and its investment banking adviser, Goldman Sachs, became strained. Goldman Sachs rejected his suggestion to put Target's land in a REIT. Target said the proposal was too risky and would dent the company's credit rating. Analysts such as Dreher agreed: "We didn't care much for that plan."

Even Michael Porter, a Harvard Business School professor and one of Ackman's advisers, sympathized with Target's refusal to be pushed around. "Target is a very, very successful company," he says. "It's a very proud company. [Target CEO] Gregg Steinhafel is a terrific leader. ... I think they were almost offended by Bill's suggestion that there were things they could do better."

Ackman embarked on a $10 million campaign in 2009 to get himself and four allies elected to Target's board of directors. He went on television and accused the discounter of having corporate governance problems. It didn't matter. He and his candidates were defeated.

What seemed to bother Ackman most was some of the bad press. Nocera, his former cheerleader, compared the hedge fund manager to "a spoiled child unaccustomed to being told, 'no.'" Ackman, in return, stayed up all night and banged out a 5,000-word response. "Mr. Nocera's article is a plagiaristic summary of Target's PR firm's positioning in this proxy contest," he wrote. "The piece has no relationship to the facts and represents the pettiest form of hateful and destructive journalism."

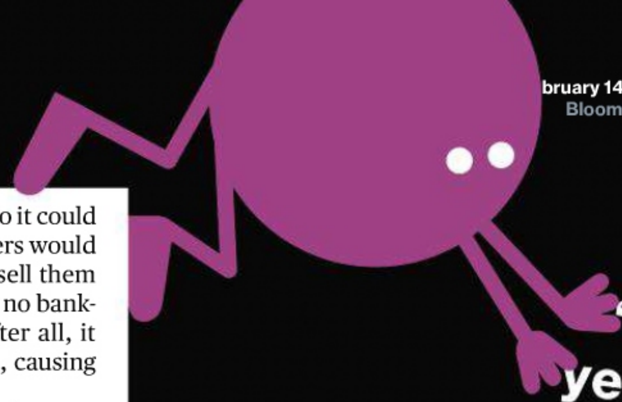
The investors in his Target fund received more gracious treatment. "We basically said, if you lost money in the Target fund, we won't charge you a fee in the main fund until you have made back those losses," Ackman says. "We have paid back a substantial majority of those investors ... over the last few years."

By the fall of 2008, he had taken an interest in General Growth Properties, a company with trophies like Faneuil Hall in Boston and South Street Seaport in New York. It was groaning under the weight of $22 billion in debt that it would have to refinance by the end of 2012. With the debt markets frozen solid, it was unclear how the company would survive.

Investors were fleeing commercial real estate, but Ackman took a different view: "I watched the stock go from $60 to 30¢. You had to look at something like that. It wasn't an Internet company stock. It's one of the most stable real estate asset classes. It just had a liquidity problem."

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He wanted General Growth to file for bankruptcy so it could negotiate extensions with his lenders. The bondholders would surely protest, hoping to seize individual malls and sell them to get their money back. Ackman says he was certain no bankruptcy court judge would allow that to happen. After all, it might further depress commercial real estate prices, causing more banks to fail.

Ackman bought 25 percent of General Growth for $60 million. Then he pushed the company to file for bankruptcy, sending the board a letter listing 10 reasons it should do so. In April 2009 the company filed for Chapter 11 protection. It was the biggest real estate bankruptcy in history.

Ackman also clamored for a board seat and accused his old nemesis, Goldman Sachs, of counseling the other directors to reject him. He found an unlikely ally in John Bucksbaum, then chairman of General Growth, whose father, Matthew, was one of the founders. In better times, Bucksbaum wouldn't have welcomed Ackman into his boardroom: "He had a reputation," Bucksbaum says.

"For five years he was wrong, wrong, wrong," says Tilson. "Then he made billions"

Things were different now. The Bucksbaums held 21 percent of General Growth's stock. Once their slice of the company had been worth $4 billion. Now it was valued at about $20 million. Bucksbaum thought it couldn't hurt to let another big shareholder onto the board, especially one such as Ackman, who would fight to get the stock price up. So in June 2009, Bucksbaum says, he cast the deciding ballot in a 5-4 vote that put Ackman on the board of General Growth Properties.

Everything else seemed to play out as Ackman predicted. General Growth's creditors tried to short-circuit the bankruptcy, but in August 2009, U.S. Bankruptcy Court Judge Allan L. Gropper denied their motion to dismiss the case. The bondholders had little choice but to grant the company a five-year extension. Ackman insists he never doubted the outcome.

In November, General Growth emerged from bankruptcy. In mid-January, its shares were trading at $15. "We turned $60 million into $1.6 billion," Ackman boasts.

He cannot always guess what judges will do. In July 2010, Pershing Square and Winthrop Realty Trust paid $45 million for $300 million of junior loans on Stuyvesant Town-Peter Cooper Village, an 11,232-unit apartment complex on the East River in Manhattan whose previous owners, Tishman Speyer and BlackRock, had defaulted on $5.4 billion worth of loans.

Ackman was sure Pershing Square and Winthrop could foreclose on the property and make a $2 billion profit. He just needed a judge to bless the foreclosure.

On the day of the hearing last October, Ackman stood on the Manhattan courthouse steps and told Bloomberg News that he was confident Judge Richard Lowe would come up with the "right answer." "This is a very analogous situation to General Growth," he insisted. He was wrong: The judge ruled that Pershing Square and Winthrop couldn't take over the property without immediately repaying the entire first mortgage. "The judge made the wrong decision," Ackman says.

This is where having a reputation can be useful. The following month, Pershing Square and Winthrop got their entire $45 million back through a settlement with CWCapital, which was servicing the mortgage. CWCapital declined to comment, but clearly it had no desire to tangle with Ackman, who could have appealed the decision and kept Stuyvesant Town tied up in court for who knows how many years. "I figured the nuisance value of our position was worth at least $45 million," the hedge fund manager says with a smile, adding, "Make that the strategic value."

There may be another blowup around the corner, but for now times are good for William Ackman. As he has correctly observed, the economy is on a rebound. But many companies are still feeling sickly–and possibly not in the mood for a public battle with a telegenic activist. Consider what happened when Pershing Square finally went after Fortune Brands.

On Oct. 8, Ackman told the SEC that Pershing Square had bought 16 million shares in Fortune Brands, which made it the conglomerate's largest investor. That put CEO Carbonari, a burly veteran of the home and security division, on the defensive. In November, Carbonari met with his new shareholder at his company's headquarters. Both men say the meeting was cordial and lasted for an hour and a half.

Ackman flew back to New York. Not long after, in early December, Carbonari announced that Fortune Brands would divide itself into three separate companies.

Carbonari insisted that Pershing Square had nothing to do with it. He said the company had been working on the plan for four years. The only praise he had for Ackman's investing acumen was faint indeed. "His timing was very good from the standpoint of coming in, if you will, in the 11th inning," he told *Bloomberg Businessweek*.

This is not a universally held opinion. "I'm going to give Bill Ackman credit," says Mario Gabelli, chairman of Gamco Investors, a mutual fund headquartered in Rye, N.Y., which owns two million shares of Fortune Brands. "Whether he forced them to do this or they were already planning on doing it doesn't really matter to us. At the end of the day, he was part of the process."

Ackman says he wasn't surprised. "The timing was right, and we make a very creditable case," he says. Fortune Brands' shares are now trading at more then $60. That means Pershing Square's stake is worth almost $320 million more than it was when the hedge fund started buying it.

So it goes. Last October, Ackman also built a position in J.C. Penney, the midmarket clothing retailer. By January the company had offered Ackman a seat on its board of directors, and he is already up $240 million. Ackman is plainly happy about J.C. Penney's sudden invitation, asking, "Who wouldn't want me on the board?" B

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Do you want to have an affair?

After hearing an ad on Howard Stern's radio show or seeing a schlocky commercial on late-night TV, you might find yourself on AshleyMadison.com—the premier "dating" website for aspiring adulterers. Type in the URL, and as the page loads a gauzy violet backdrop appears with a fuzzy image of a half-dressed couple going at it beyond a hotel doorway. "Join FREE & change your life today. Guaranteed!"

Setting up a profile costs nothing and takes about 12 seconds. First you check off your availability status: "attached male seeking females," "attached female seeking males," or, even though the concept of the site is that all users are in relationships and therefore equally invested in secrecy, "single female seeking males." Next you're asked for location, date of birth, height and weight, and whether you're looking for something "short term," "long term," "Cyber affair/Erotic Chat," "Whatever Excites Me," and so on. If you're like me, you choose a handle based on the cupcake you most recently ate—"redvelvet2"—and then shave a few years and pounds off your numbers.

Once you provide an e-mail address that your spouse would presumably never have access to, you're thrust into Ashley Madison's low-tech pink and purple interface. And then, if you're a woman, the onslaught begins.

CHEATING, INCORPORATED

Looking to sneak around on your spouse? Got a little cash to spend? The CEO of Ashley Madison, a website whose own backers don't even want to be associated with it, is happy to take your money

BY SHEELAH KOLHATKAR

PHOTOGRAPH BY FINN O'HARA

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CEO Noel Biderman says monogamy "is a failed experiment"



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"THIS GUY IS PREYING ON HUMAN FRAILTY," SAYS ANTHROPOLOGIST HELEN FISHER. "IT'S A LITTLE BIT LIKE PIMPING IF HE'S MAKING MONEY"

TDH071 ("Like foreign guys with accents?"): Hi, would u like to chat? I luv tall women!!
Needtotry2011 ("life is short, make it count!"): Hello!
Dirtybear2010 ("Seeking Ladies seeking NSA Discreet Fun"): Hello Red

There's a lone genius—possibly evil and certainly entrepreneurial—behind Ashley Madison. His name is Noel Biderman, and he's the chief executive officer of Avid Life Media, based in Toronto. "Monogamy, in my opinion, is a failed experiment," he declares. It's unclear if Biderman actually believes this—he's married and has two young kids—but like Hugh Hefner before him the business he has created pretty much requires that he say it. Behind his desk, in an office so lacking in embellishment it almost looks like a hastily assembled low-budget film set, is a large flatscreen monitor promoting his company's flagship brand. It reads: "Life is short. Have an affair."

Adultery has been good to Biderman, but defending his product is a full-time job. The day before our meeting, Ashley Madison had blasted out a press release accusing Fox of refusing to broadcast its Super Bowl commercial. When I arrived, Avid Life's offices were still crackling with outrage, with Biderman playing the role of the unfairly maligned business owner just trying to make an honest living. While Biderman scheduled calls with reporters from CNN, ESPN, and a Peterborough (Ont.) radio station called The Wolf to discuss the perceived injustice against his company, a film crew set up lights to shoot a segment for a documentary about the "science of sin." Down the hall, the 107 programmers, designers, customer service agents, and marketing folk who run Avid Life's six websites—including cougarlife.com, for older women seeking younger men, establishedmen.com, which connects "ambitious and attractive girls" with "successful and generous benefactors to fulfill their lifestyle needs," and hotornot.com, the 1990s throwback where people rate one another's photos—were plotting Avid Life's digital push into the future.

"How could I not be angry?" Biderman, 39, asks of the Super Bowl affront.

One expects the guiding light of an operation such as his to be more like Joe Francis, the hard-partying creator of the *Girls Gone Wild* franchise, than Mitt Romney, but Biderman tends towards the latter: He wears a sports jacket and is preppy and well-built, with a tuft of hair at the tip of his forehead. Fox declined to comment on the Ashley Madison commercial, although it's worth noting that during the most-watched Super Bowl in history, the network broadcast an ad for GoDaddy.com, in which racecar driver Danika Patrick wears a skintight body suit, and an Adam Sandler movie trailer featuring a barely-dressed jiggling woman. In any case, rejection is nothing new to Biderman, whose business has grown in part through the predictable media attention that's generated when a company that profits by encouraging people to cheat on their spouses tries to push further into the mainstream. "I think when a landscape is tilted against you like that ... isn't that how women the generation before felt when they couldn't get a fair shake in jobs? Because of their gender?" Biderman continues. "It's the same thing. I'm angry because it's not logical."

After spending several years as a sports agent at Chicago's Interperformances, Biderman founded Ashley Madison in 2002, naming the company after the two most popular names for baby girls that year. A large chunk of his work as an agent involved helping professional basketball players juggle their wives and mistresses, so when he read somewhere that 30 percent of users of Internet dating services were pretending to be single when they weren't, a light went on, pointing the way to an underserved online niche market. What would happen, Biderman thought, if cheaters had a website all their own?

Biderman presented the idea to his business partner at the time, Darren Morgenstern. They tried to hold focus groups to figure out what philanderers would want in a website, but gave up, hired "a computer geek from Australia," and threw up a bare bones interface. From there, they came to better understand their customers, especially the reasons they were seeking affairs. More than a hundred employees later, the staff skews young, with shaggy hipsters occupying the programming stations and more conservative types in the executive wing. Rizwan Jiwan, the vice-president for product marketing, has an engineering degree and an MBA, and formerly worked at Research in Motion. "My girlfriend pushed me to accept the job," he says.

It's not easy to get a handle on the size of the fling economy. The Internet dating market is worth $1 billion to $1.5 billion in the U.S., according to industry website Online Dating Insider, and some portion of that, from 10 percent to 30 percent, depending on whom you ask, involves people who are already in relationships. Match.com and Facebook, as well as raunchier sites such as Adult FriendFinder, all had a piece of what Biderman was after; still, he essentially had to create a market for Ashley Madison, which is by far Avid Life's most successful brand. Craigslist, where much adulterous activity used to live, shut down its "adult services" section last year after it was accused of abetting sex trafficking and prostitution. The average number of daily visitors to Ashley Madison has grown 13 percent since then.

Avid Life is privately held, making its numbers difficult to verify, but according to the company, Ashley Madison has 8.5 million members, 1.3 million of whom have actually paid something. It now has a presence in 10 countries—the U.S., Canada,

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Australia, the U.K., Germany, Switzerland, Austria, Ireland, New Zealand, and Sweden—with plans to enter Italy, Spain, and Brazil in the next year. Not surprisingly, the majority of its users are men—an estimate on the site says there are seven of them for every three women. Based on internal projections, Avid Life is expected to generate $60 million in revenue this year and $20 million in profit. Almost all of that comes from Ashley Madison.

Promoting adultery and creating a market for it has made Biderman rich. It has not made him popular. "Nobody knows how many people are adulterous. But there is something important here," says Helen Fisher, an anthropologist specializing in love and relationships who is also a consultant to the dating site Match.com. "Even though some people are predisposed to adultery, we do have a big cerebral cortex with which we make decisions—some people are predisposed to alcohol and they give up drinking, drug addicts overcome addiction. This guy is preying on human frailty. It's a little bit like pimping if he's making money." Still, "they certainly own that cheaters' market," said David Evans, publisher of Online Dating Insider. "It's quite lucrative and successful."

What Ashley Madison does is legal. It's also illicit, in that it helps users violate their marriage vows and engage in deception and secrecy. This presents enormous branding challenges as well as financial ones: How many fund managers want to go home to their wives and announce, "Honey, I found the perfect investment opportunity!" Some of Avid Life's employees don't publicly admit where they work for fear of jeopardizing their spouses' jobs, provoking family disapproval, or seeing their houses pelted with oranges; Biderman says he sometimes worries about his security. All of this puts him in a unique position: He is running a budding empire built on an activity that most people would say is wrong. Is that the easiest thing in the world or the most difficult?

Ashley Madison is what Biderman calls a "female-focused brand." Everything from the site's girly colors to the name is meant to entice those elusive XX chromosomes, the target of ladies' night two-for-one drink specials the world over. It was a particular dilemma, in this case, trying to appeal to the very demographic—married women—who were most likely to be disgusted by the nature of the goods being offered. "I was very confident that men would gravitate towards a service to conduct these otherwise anonymous affairs. They were seemingly doing it already," says Biderman. "I was much less confident that women would behave that way."

According to the research he cites, women are most likely to have affairs in one of two places: at the office with a "work husband," or within their social circle, with "a friend's partner, a sister's partner," or someone else they are close to. "For them to go and have anonymous affairs, I was almost gonna have to create that paradigm," Biderman says. "And to do that I felt that women were going to have to feel that there was... I don't want to say a woman behind it, but definitely that they were the focal point."

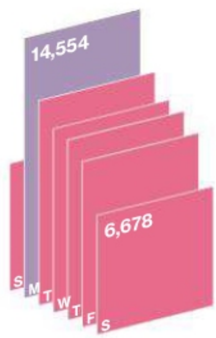
Surfing the Internet, with its angry anonymous commenters, porn, and gambling, can sometimes feel like freebasing testosterone, a journey into a giant bazaar of the male id. Relationships that start there tend to go backwards. Instead of getting to know someone gradually, your face is rubbed into their most intimate details right away, while you may never learn their real name or where they live. This approach seems to appeal more to men.

Just as Biderman predicted, Ashley Madison is drowning in husbands, so many that they threaten to crush the few venturesome ladies who have boldly—and perhaps recklessly—put themselves out there. Each time you log on as a female, it's as if a new batch of peanut butter packets has been dropped over a refugee camp—everyone leaps at them at once, and you are overwhelmed with messages, "winks," and men attempting to interact. The pricing system is cleverly designed to charge the men at their most vulnerable moment: Each time one of those hungry males tries to grab at the peanut butter, he has to spend a few bucks. Creating a profile and browsing others are free, but if you'd like to initiate an e-mail or chat conversation with someone, you must purchase "credits"—200 of them cost $79.00, and they run like a meter (e-mails after the first one cost nothing; charges appear ambiguously on your credit card bill).

It's astonishing how quickly those little beans slip away: After signing up for an introductory $49 package, I sent messages to 11 women asking to interview them. As soon as I noticed that one had responded, a box appeared on my screen, informing me I was out of ammunition and had to buy more. The biggest advantage of this pricing, Biderman says, is that it "makes people be a lot more thoughtful and selective with the messaging they send when they realize there is a toll." It also appears to be quite lucrative. Because no one in the history of Ashley Madison has ever heard of a female member having to initiate contact with a man, ladies effectively drink free.

SPIKES IN NEW REGISTRATIONS ON ASHLEYMADISON.COM IN 2010

The day after New Year's Day
Men 78%
Women 22%



EACH TIME YOU LOG ON AS A FEMALE, IT'S AS IF A NEW BATCH OF PEANUT BUTTER PACKETS HAS BEEN DROPPED

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JUDGING FROM THEIR PROFILES, MANY OF THE SINGLE WOMEN

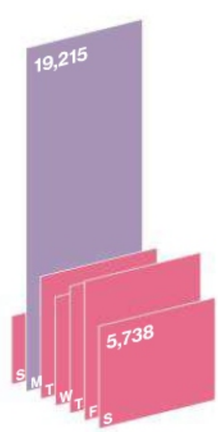
Case in point: On a recent Saturday afternoon, three minutes after I logged on, the box at the top of my screen had filled with four attempts at correspondence. The queue quickly grew so long I couldn't keep track of it.

Then someone named "quietriot12" ("Casual and Causal") sent me a "Pre-Contact Message," asking if I wanted to initiate a chat session. (This seems to be a way to avoid blowing credits by trying to chat with someone who isn't going to respond.) It was quietriot12's second attempt that day—he had already sent me a key to a "private showcase," which consisted of two photos of himself. Unlike many of the other showcase pictures out there, quietriot12's were of his face. He looked sort of hunky and clean-cut, with short dark hair, and he was evidently a sports freak, judging by one image snapped at a baseball game. His profile said he was 40, liked women who were stylish/classy and had natural breasts, and that he was a social drinker. "Boating? Karaoke?"

Before I could respond to that one, "2011_Intrigue" ("Pursuing unfulfilled desirs") cut in with: "hi... beautiful day... red velvet might be the key. are you opened minded?" Then "willy63" ("1111111") wanted to know: "r u on?"

Research suggests that 20 to 40 percent of heterosexual married men and 20 to 25 percent of heterosexual married women will have an affair during their lifetime. Moreover, men have an evolutionary prerogative to spread their genes as widely as possible, while women are driven to find a mate and try to gain access to the best genes out there by any means necessary. Bruce Elmslie, an economist at the University of New Hampshire who has studied the economic impact of infidelity, found that up to the ages of 35 or 40, women and men are equally likely to cheat; after that, the women slow down while the men keep doing it, which makes sense from a purely reproductive perspective. Women are also more thoughtful about it, Elmslie found, while men are less likely to "consider the costs" and will do it almost with whoever is available.

The day after Valentine's Day
Men 52%
Women 48%



Curiously, Australia, where Ashley Madison was launched in April 2010, has the highest proportion of women users, at almost 40 percent. Biderman spent a few weeks there and says he noticed that prostitution is legal and that Aussie women aren't happy about it. "I think women down there have a view of the world that men have all these playgrounds—brothels, strip clubs, massage parlors," he says, "and they have nothing." Biederman has spent so much time studying his users, he sounds like an amateur sociologist: "We know there's a lot of doctors on there with god complexes who clearly either deal with so much stress in their lives, or believe they're so important, that having an affair—they're entitled to it." Also, real estate agents "went through the roof" during the financial crisis, along with executives from Wall Street.

While stress and cultural factors may drive use, looks apparently do not, at least for the men. "If you sat down with 20 people who'd had an affair and said, rate the person you had an affair with 'better looking' or 'worse looking' than your partner, almost 90 percent'll say worse," Biderman says. "You can build a profile right now of an unattractive woman, overweight, whatever, she'll still have a dozen men interested in meeting her." Either way, the pool of potential cheaters—and customers—is huge.

Twenty percent of Ashley Madison's female members are single, according to the site's administrators. Several experts, including Elmslie, suggest that the vast pool of husbands and large number of young, unattached women creates a dynamic that could be exploited for prostitution. After all, why would unmarried women go out searching for men who are taken? Judging from their profiles, many of them are looking for guys who will take them shopping: "Single Lady from New York, artist seeking ideally mutually beneficial Sugar Daddy/Sugar Baby type of LTR," writes one "ArtPrincess" ("I;ve got brains, booty and boobs :)"). In response, Biderman says, "Is that any different from any dating scenario? If you take a woman out and buy her a diamond ring and a Valentine's gift—that is how the world works." He adds, "I remove anybody soliciting. We try really hard. We are not interested in that."

Biderman is quick to explain why his business isn't hurting anyone. "You eradicate Ashley Madison, you're not going to eradicate infidelity. That's what allows me to sleep at night," he says. "If you think that all affairs happen on Ashley Madison, you're very naive. The majority happen in the workplace. People are thrust together, that's where they happen." In that context, Biderman likes to argue, affairs can be much more damaging, by causing meltdowns at work, becoming public, and blowing up marriages. Ashley Madison and its clandestine, more transactional approach, he says, is actually a marriage *saver,* a public service of a kind. "Do you think if you stop allowing divorce attorneys to advertise, we would stop people from getting divorced?" he says.

According to Justin Wolfers, an economist at the Wharton School of

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the University of Pennsylvania, Ashley Madison provides liquidity to an illiquid market, which may make the market bigger. "The labor market is all about workers trying to find jobs and jobs trying to find workers," Wolfers said. "In the romance market, technologies like the Internet are helpful in making those matchings more efficient, so if it makes it easier to find a mate, presumably it would create more of these ventures."

Biderman doesn't agree, but beyond that he makes the case that no marriage is defined entirely by sex. "I have two children, I have a wonderful extended family, I have deep economic ties," he says. "If I woke up and found my partner wasn't interested in being with me sexually and I tried to do everything I could but sex was now off her radar... Well, sex is important in my marriage—it is—but it's not No. 1 and it's not No. 2. So I would stray before I would just leave, because maybe that would give me enough of what I need to stay within my marriage to do all the other things that are critical to me."



The day after Mother's Day
Men 23%
Women 77%

When I asked Biderman's wife, Amanda, what it's like being joined in holy matrimony with an anti-marriage entrepreneur, she let out a long sigh. "Really, the business itself doesn't match who he is as a person—it's not our lifestyle or value system or any of that," she said. "I mean, yeah, I'd love it if he were working on a cure for cancer. But it's a business, and that's how we look at it."

"Fitnslim," who responded to a request for subjects that Ashley Madison e-mailed to its members, told me over the phone that she learned about the site in a magazine she read while getting her hair done about a year ago. She's a former model in her 50s and is in very good shape. "There's apparently a lot of older women who do not like sex," she said. "I'm not one of them." Her husband is considerably older than she is and has "zero" interest, so she has long maintained an outside gentleman friend. When one relationship ends, she goes out and finds another. "First of all, what I liked about it is, as a woman, it's free," Fitnslim said. "I have a very nice lifestyle that many people would envy. If I'm going to be with someone else, I want it to be with someone of a caliber I'm at, meaning someone who has the money to go out. The good thing about this website I discovered—all the men have to pay. Apparently that eliminates people who don't have any money or who don't want to spend it."

She said she typically received eight to 10 messages a day—more than she could pursue—and said many were from much younger men, which she found amusing. She has been out for drinks or dinner with a handful. "There was one nut, O.K.," she said, "but other than that, most of the people I would classify pretty much as successful businessmen, many of whom travel constantly for their jobs—which is why they are able to do what they do, by the way." She's on her second Ashley Madison boyfriend and is hoping it lasts for a while.

Talking to regular users is not an uplifting experience. One 34-year-old woman, who goes by "34pinay," is married with young kids, including a baby. She told me she'd just ended a year-long romance with a Marine who was deployed to Afghanistan, who himself is married with three kids, one not biologically his (his wife cheated on him while he was serving overseas). She met the Marine through a free singles dating site called Plenty Of Fish, just the sort of thing that competes with what Ashley Madison has to offer. I didn't ask 34pinay how she found the time for an extracurricular romance while she was pregnant and dealing with a newborn, but she said that for now, at least, she was mainly browsing Ashley Madison profiles for amusement, although she has met a few men for drinks. "It's really strange," she said. "I got some comments from them—'why are you on that site if you don't want to sleep around? That's what that site is for.'" She was horrified. "I'm not there because of the sex," she said. "It's more that I'm missing the excitement of being in love. My husband and I, we don't really talk any more, it's more of a roommate relationship. We're staying together for the kids. Guys seem to think after one drink they can touch you." She has an e-mail thing going with a married doctor who's a little more patient.

Another woman—"luckyjane"—said she worked in finance and described herself as a "risk taker and seeker by nature." Her photo made her look sort of dominatrix-ish—she had long blond hair and wore a tight black outfit showing lots of cleavage, and she said she was single. "You may or may not be surprised at the number of people on the street who are on here looking for something 'strange,'" she wrote. "Being a woman on wall street is a unique experience, but I will say regardless of that, spouses can never fully understand the pressures and resulting need for extracurricular releases ... and this does not even address the number of guys on this site not on wall street, who are stuck in loveless, sexless marriages. This site is enormously interesting."

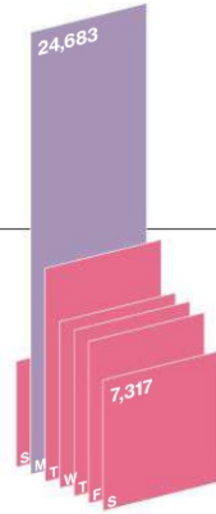
"Next to Facebook, we're probably going to be

ARE LOOKING FOR MEN WHO WILL TAKE THEM SHOPPING

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AFTER READING A PROFILE FROM ASHLEYMADISON.COM, THE BANK ARRANGING THE FINANCING WITHDREW FROM THE DEAL

the fastest-growing social network on the planet," Biderman says. Next to defending adultery, Mark Zuckerberg's company is Biderman's fastest-growing obsession–an inspiration, a competitor, and a cruel gatekeeper. "It really baffles me that a young startup company like Facebook won't take my ad," he says. "It really, genuinely baffles me. I don't know what they're playing at."



The day after Fathers Day
Men 87%
Women 13%

Biderman was sitting in his office, waiting for an interviewer to arrive from his alma mater, York University's Osgoode Hall Law School. The conversation had turned, once again, to the subject of how unfairly he is treated in the marketplace. "How many companies do you know, if they wanted to buy their own brand as a key word in a search engine, like MSN, they can't even do that, can't even defend their own territory?" he asks. "Can't buy the word 'infidelity,' which is troubling, I would think. I think it's my role in that conversation to say, hey, isn't that a problem?"

This proved to be a big problem last year, when Avid Life Media attempted to raise C$60 million through a private placement of shares, with plans to go public through a reverse takeover of a shell company on the Toronto Stock Exchange. The deal was a disaster. Ashley Madison had become infamous by then after unsuccessfully lobbying the Toronto Transit Commission for the right to plaster advertisements on city streetcars. The company had been struggling to find a way to grow since 2006, when Biderman needed to raise C$10 million to buy out his partner Morgenstern. Biderman says his investors wanted him to branch out into other businesses beyond the affairs market, so Avid Life was conceived as a "diversified media company," and it bought Web properties dealing with real estate, green living, and pets. (Biderman continued running Ashley Madison while an outside CEO ran Avid Life until Biderman was given the CEO job last June.) The strategy shift didn't work out, so a decision was made to focus the company exclusively on online dating, and Avid Life bought hotornot.com for $22 million and launched establishedmen.com, cougarlife.com, and several others.

Finally, Avid Life hired a Canadian investment bank called GMP Securities to manage the C$60 million private placement, which was supposed to happen on Feb. 15, 2010, according to the term sheet. In 2009, Avid Life had posted $30 million in sales and an $8 million profit, a fourfold increase over the previous year. After the placement was done, the plan was to buy a larger company called Moxy Media, an "arbitrage" business that made money buying Web traffic from search engines and redirecting it to pages covered with ads or links. The larger, more diversified entity was then going to stage a reverse merger and get itself onto the TSX. The deal was the talk of the Toronto financial community. On Jan. 29, 2010, a *Canadian Business* magazine reporter named Thomas Watson confronted Kevin Sullivan, the CEO of GMP Securities, with a printout of an online profile posted on Ashley Madison's website: "To be honest I'm really looking for a sugar daddy, so if that isn't you I wouldn't waste your time replying," it read. "I'm looking for a generous man that loves to take care of a younger lady, i am 18 and have just started university and my parents aren't paying a cent for it ... if there is a nicer gentlemen on here that really gets off on helping a young women with some bills, taking stress of her shoulders while recieveing the same back both emotionaly and physically please msg me." Sullivan squirmed. The following Monday, GMP walked away from the deal. GMP declined to make any executives available for comment, but the bank's reaction was hardly shocking. Biderman says Avid Life's majority owners, a handful of high-net-worth investors and hedge fund types, don't want to be associated with their baby for fear of damaging their reputations.

There's no precedent in the public markets for precisely what Ashley Madison does, but Adult FriendFinder, the self-described "world's largest sex and swingers personals community," might offer a glimpse of the future. In 2007 the founder, Andrew Conru, told *The New York Times* he had met with "a dozen venture capitalists" over the previous few years, with little success. FriendFinder's parent company, Various Inc. , was eventually sold to Penthouse for $500 million. In 2010 it tried to hold an initial public offering but later canceled it because the market was "weak," Conru said at the time.

Biderman says none of this history matters. Avid Life is growing just fine, thank you very much. "To me this is a great, privately held company. And that's the other thing, the IPO attempt was a Canadian IPO attempt, which is absolutely the wrong attempt. This has got a bigger goal. We've got to find a way into the U.S."

"They pay me seven figures-plus a year. I earn millions of dollars a year running it. I have the equity component, which some day should hopefully be worth a lot," he goes on. "It's gonna ultimately come down to how this company gets valued. Mark Zuckerberg might only take $100,000 a year, but ultimately he's going to be worth billions of dollars."

Then Biderman paused to check his BlackBerry. "My wife just called, that's the one phone call I like to return," he says. "It's my son's birthday today. I'm supposed to sneak out to go to his school to give him a cake." Ⓑ


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"SOCIETY TENDS TO LOOK FOR SCAPEGOATS AND THEN SHOOTS THEM. BUT WHAT IF THE PROBLEM GOES DEEPER?"

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CHARTING THE FAULT LINES

CHICAGO'S RAGHURAM RAJAN IS WORRIED ABOUT INCOME INEQUALITY AND DEBTS TO CHINA

BY PETER COY

PHOTOGRAPH BY JEFF WILSON

As the son of a diplomat, Raghuram G. Rajan lived outside of his native India for most of his childhood. In 1974, at age 11, he moved back to India from Belgium and got the shock of his young life. The widespread poverty stunned him, but it wasn't just that. Even for middle-class families like his, nothing seemed to work in Indira Gandhi's India, a nation choked by regulation. "I went from seeing the supermarket filled and toys galore to a country where you had to hunt for bread, and milk was a luxury," says Rajan. "Even people who had money had nothing to spend it on."

A light went on in the boy's head: It doesn't have to be this way. "My friends in India were as smart as my friends in Belgium," Rajan says today. "The sense of how bad government can be when it tries to do too much is from those years. But also what good government can do."

At 48, Rajan is still obsessing over the problems that captured his attention as a boy in New Delhi. Only now he's applying his thinking on a global stage. Having served as the chief economist of the International Monetary Fund from 2003 to 2006, he has returned to his endowed chair at the University of Chicago's Booth School of Business and is the author of a much discussed 2010 book, *Fault Lines: How Hidden Fractures Still Threaten the World Economy*. Those fault lines include rising inequality in the U.S. and the dependence of the wealthy U.S. on loans from poorer China.

Rajan's arguments about what destabilized the financial world and how to respond have emerged from a pack of competing theories to capture the attention of opinion makers. When *Foreign Policy* magazine asked its 100 "global thinkers of the year" for book recommendations, *Fault Lines* came out on top, with plugs from Yale University economist Robert J. Shiller and New York University economist Nouriel Roubini, among others. Rajan says he has received congratulatory notes about the book from former British Prime Minister Gordon Brown and European Central Bank President Jean-Claude Trichet.

The high-level attention has made Rajan a player in the debate over how to prevent severe economic crises. Yale's Shiller says the book was cited repeatedly at a Goldman Sachs conference he attended on Jan. 19. "It's not typical finance-department work," Shiller says. "Raghu is more of a broad intellectual than is typical in business schools." Kenneth Rogoff, a Harvard University economist who preceded Rajan as the IMF's chief economist, says his book "is getting a lot

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of attention because it presents a particularly deep political economy analysis of the global imbalances. ... Perhaps he carries the argument too far, but there is certainly a ring of truth to it."

Rajan sat for an interview in January in Denver, a city overrun by dismal scientists attending the annual meetings of the Allied Social Science Assns. As the new president of the American Finance Assn., he was in such demand that he had to hide on a bench behind a partition to get a quiet moment.

American economists have been divided since the 1970s between salt and fresh. The "saltwater" school is more Keynesian, often liberal, and strong in coastal universities such as Harvard, the Massachusetts Institute of Technology, Princeton, and the University of California at Berkeley. The "freshwater" school is more free-market-oriented and began at schools clustered around the Great Lakes such as Carnegie Mellon University and the universities of Chicago, Minnesota, and Rochester. The financial crisis created an opening for an unconventional economist such as Rajan, who pulls together ideas from both schools (call him brackish). "I'm a pragmatic economist," he says. "I've seen too much failure on both sides."

One reason Rajan has drawn so many admirers is his willingness to tackle big themes such as poverty and the power of banks, instead of keeping his head buried in the academic weeds of elasticities, volatilities, and heteroscedasticities. Luigi Zingales, a Chicago Booth colleague and co-author of Rajan's previous book, *Saving Capitalism from the Capitalists*, says, "There's a tension between saying nothing precise and precisely nothing. The economics profession is going in the direction of saying precisely nothing."

In person, Rajan is calm and genial, even when engaged in debate. He's not timid, though. *Fault Lines* recounts an episode in 2005 when he was serving as chief economist of the IMF and implied to a reporter that Britain might need to raise taxes. That contradicted the public statements of Gordon Brown, then Chancellor of the Exchequer, who lambasted the IMF at a press conference the next day. Rajan and his boss, Managing Director Rodrigo de Rato, didn't back down. Brown's congratulatory note to Rajan on the scholar's book suggests that the former PM's respect for the author overshadows any hard feelings.

Rajan's family arrived in Indonesia in 1966, a time of political turmoil captured in the book and film *The Year of Living Dangerously*, when President Sukarno was overthrown and hundreds of thousands of Indonesians died in anticommunist purges. In 1969 the family moved to Sri Lanka. In 1971 it was on to Belgium, a prosperous country that left Rajan ill-prepared for his return to India three years later.

Despite an early interest in social and economic tensions, Rajan took what he calls "the road to safety" and got his first degree, in 1985, in electrical engineering. Two years later, still hankering for economics, he earned an MBA from the elite Indian Institute of Management in Ahmedabad. Classmate Srinivas Shastri recalls him as "a damn compassionate guy." Shastri wrote in an e-mail: "I still remember how he dismissed me with the slower ball in a cricket match"—the equivalent of an off-speed pitch in baseball—"and later apologized!" Another classmate, Radhika, became the love of his life. "We argued so much we decided we could never be in the same group again, but eventually did get married," Rajan says. The couple has two teenage children.

After Ahmedabad, Rajan went to the U.S. and in 1991 got a PhD in economics from MIT. Then he got a teaching job at the University of Chicago, whose Gothic-style campus in the Hyde Park neighborhood has been his base ever since. In 2003, the same year he began his three-year stint at the IMF, he was named the first recipient of the American Finance Assn.'s Fischer Black Prize for the person under age 40 who has contributed the most to finance theory and practice.

In addition to presiding over the American Finance Assn. this year, Rajan is an economic adviser to Indian Prime Minister Manmohan Singh. He chaired an Indian committee on financial reforms that produced a report called *A Hundred Small Steps*. He's also an academic adviser to the U.S. Comptroller General, Moody's Investors Service, Brazil's Bank Itaú-Unibanco, BDT Capital Partners, which invests in closely held companies, and Booz & Co., the strategic consulting firm. "I do try and protect space for research and continue writing a few academic papers a year," Rajan says.

On Aug. 27, 2005, Rajan gave a speech that made his reputation as someone with a special understanding of the global economy. It was a dispassionately delivered warning to the world's central bankers at their annual retreat in Jackson Hole, Wyo. Most of the speakers lavished praise on attendee Alan Greenspan, who was completing a much lauded final year as Fed chairman. Rajan used his turn at the lectern to present a paper called "Has Financial Development Made the World Riskier?" "Something as intimate as credit risk is now being traded with strangers," he said, noting that banks, displaced from conventional lending, were relying on riskier profit-making strategies such as providing backup lines of credit for corporate commercial paper. "Competition," he continued, "forces them to flirt continuously with the limits of illiquidity."

He observed that investment managers' returns were "convex," meaning their personal upside for taking more risk was great and their downside was trivial. Although markets seemed tranquil, Rajan warned against complacency, noting "the absence of volatility does not imply the absence of risk." His advice: Be wary of keeping interest rates too low, and fix the incentives in regulation—for example, by requiring investment managers to invest a portion of their pay in the assets they manage and barring them from pulling the money out until a year after they quit.

He was treated like a skunk at the party. Lawrence Summers, the former Treasury Secretary who was then the president of Harvard University, said he found "the basic, slightly Luddite premise of this paper to be largely misguided." After several other speakers piled on, albeit more politely, Princeton University economist Alan Blinder defended Rajan from what he called "the unremitting attack he is getting here for not being a sufficiently good Chicago economist" ("Chicago" being shorthand for free-market). In *Fault Lines*, Rajan writes, "I exaggerate only a bit when I say I felt like an early Christian who had wandered into a convention of half-starved lions."

Of course, Rajan was soon proven correct. *Fault Lines* is not, however, just a 260-page I-told-you-so. It's an attempt to identify the roots of the crisis and propose ways to make the system less vulnerable to another cataclysm. It's also an attempt

"I FELT LIKE AN EARLY CHRISTIAN WHO HAD WANDERED INTO A CONVENTION OF HALF-STARVED LIONS"

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to heal the intellectual fault line between market libertarians, who have no faith in government, and social liberals, who have no faith in unfettered markets.

Rajan champions the "freshwater," free-market argument that Federal Reserve Chairman Ben Bernanke is risking another dangerous asset bubble by keeping interest rates too low for too long. That puts him in the same camp as such conservatives as John B. Taylor, Treasury Under Secretary for International Affairs in the George W. Bush Administration. Rajan faults Fannie Mae and Freddie Mac for pumping too much money into subprime mortgage loans and the Community Reinvestment Act for pressuring banks into extending credit to supposedly underserved communities.

Such views have not won him praise from the "saltiest" thinkers. Princeton's Paul Krugman, the Nobel laureate and *New York Times* columnist, blasted *Fault Lines* in *The New York Review of Books*, scolding Rajan for "buy[ing] into what is mainly a politically motivated myth." Rajan responded in *The American*, the magazine run by the conservative American Enterprise Institute, with "Many Are the Errors." "Perhaps Paul Krugman believes that by labeling other economists as politically extreme, he can undercut their credibility. But his is badly weakened by the myriad errors he makes," ran the story's subhead. It was just the kind of language you'd expect from an economist with a signed poster of Milton and Rose Friedman on the wall of his office.

If Rajan has the heart of a conservative, it's also a heart that bleeds. He says the excesses in subprime lending were a misguided attempt to deal with what he considers a very real problem, namely rising income inequality. He produces statistics showing that Americans in the upper income echelons are doing fine, while those in the middle and the bottom are losing ground. Borrowing by those less successful groups allowed them to spend as if they were better off than they really were, but it couldn't last. It would be far wiser, Rajan argues, to deal with the root causes of inequality by helping the poor and middle class get a better education so they can be more competitive in the now-global labor market.

Rajan argues that the Fed's cheap-money policies are a bad solution to another acute problem—namely, the weakness of America's social safety net. If the net were stronger, as it is in Europe, he says, being jobless would be less painful, and the Fed could allow the economy to recover at a natural pace without feeling political pressure to overstimulate the economy in the hope of creating jobs.

So while parts of *Fault Lines* sound positively Ron Paul-ish, others could have come from the liberal wing of the Democratic Party. "In this debate," Rajan writes, "few legislators have asked how U.S. society can remain healthy and humane with a sick and unprotected immigrant population in its midst. If nothing is done, inequality will feed on itself."

"HOW [CAN] U.S. SOCIETY REMAIN HEALTHY AND HUMANE WITH A SICK AND UNPROTECTED IMMIGRANT POPULATION?"

Maybe that's his Indian background peeking through. MIT economist Abhijit Banerjee says poverty and inequality are central concerns for most Indian-born economists across the political and economic spectrum. "I'm a creature of the country I grew up in. You know there has to be an answer," Rajan said in Denver.

If there's a fault in *Fault Lines*, it's in Rajan's proposed solutions. Some are doable but not sufficient to fix the problem, while others might be enough to fix the problem but are not especially doable. Among his ideas: withhold traders' bonuses for a few years until it's clear their initially winning trades don't lead to disaster later, break up Fannie Mae and Freddie Mac, close the revolving door between Wall Street and the regulatory agencies, devote more resources to very young children in poor families, pay teachers more for outstanding performance, promote charter schools and vouchers, make health insurance universal, consider a value-added tax and a carbon tax, and phase out deposit insurance to expose banks to more market discipline.

One of his most ambitious proposals is for the IMF to gain influence by "appealing more directly to a country's citizens," including China's "thinking middle class." It might not work, writes Rajan, but "in going beyond their comfort zone, multilateral organizations have little to lose but their irrelevance."

Rajan faced a tough crowd at January's meetings in Denver. On a Friday morning at 8 a.m. he made a slide presentation of his thesis using charts and equations. "Society tends to look for scapegoats and then shoots them. But what if the problem goes deeper?" he asked the audience of about 80 people.

Then two of the top economists of his generation took shots at him with their own slide presentations. It was the economics profession's equivalent of the National Basketball Assn.'s slam-dunk contest: Top that! In your face!

After praising Rajan, MIT's Daron Acemoglu questioned whether he had his causality wrong. Instead of trying to help the poor by stoking the subprime lending craze, Acemoglu said, perhaps members of Congress were trying to fuel the business of the financial elites who pay for their election campaigns. Acemoglu cited a line attributed to Republican Senator Mark Hanna (1837-1904): "There are two things that are important in politics. The first is money, and I can't remember what the second one is."

Edward Glaeser of Harvard University and the free-market Manhattan Institute also lauded Rajan—and then hit him from a different direction, citing data showing that lax lending practices explain only a small portion of the bubble in U.S. housing prices.

A day later, Rajan seemed to have taken the Acemoglu/Glaeser one-two punch in stride. "The differences of opinion are smaller than they appear," he said. He conceded that some pieces of his argument, in particular the assertion about Congress's motive in promoting subprime mortgage lending, were not as nailed down as they would have been in a refereed academic paper. "I'm making a leap. That's what a book allows me to do," he said. Echoing his earlier co-author Zingales, Rajan said, "You have to have an expertise. But there have to be some people who can talk about the broader structure."

As an economic seismologist, Rajan isn't satisfied just identifying the fault lines in the global economy. He wants to heal them, too. "The cost of doing nothing," he writes, "is perhaps worse turmoil than what we have experienced recently" because "unchecked, the fault lines will only deepen." B

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*Morningstar *FundInvestor*, June 2010. Morningstar evaluated the 30 largest fund groups (based on asset size) on the following measures: manager retention rates over the last 5 years; average fund management tenure (how long the portfolio managers have managed their funds); fund managers' investment in the funds they manage; 3-year asset-weighted performance of all share classes; and Morningstar Stewardship Grades, which evaluate a fund group's culture, fees, Boards of Directors, manager incentives, and regulatory records. Data used were as of 5/31/10 except for manager retention, which is through 12/31/09. **Morningstar made its selections based on low cost, a focus on investors' interests, consistent investment strategy, and fund manager experience. ©2011 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. [1]Companies in the health sciences industry are vulnerable to product liability lawsuits and competition from low-cost generic products.

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Trainer-flirters, mirror-flexers, and others page 78

The Startup Café & Gym Behavior & Rummy

Etc.

The ultimate at-home office gadgets page 80





The Weathermen, Underground

Technology and the recession are threatening the cultural hegemony –and job security–of the TV weathercaster. *By Eric Spitznagel*

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Etc. Weathermen

Nick Kosir's big break as a TV weatherman was pure happenstance. While working in 2009 as a reporter for KBTV in Beaumont, Tex., his producer sat him down for a heart-to-heart. The weathercaster for *Good Day*, KBTV's morning show, had just quit, and Kosir had been tapped for the job. "I was a terrible reporter," he recalls. "I could screw up a cat show story. My boss was like, 'Either you start doing the weather or you're gone.' " Kosir accepted the challenge and soon had an epiphany: To distinguish himself from the horde of genial, generically attractive forecasters, he wouldn't merely read the weather—he would *rap* it. After nine months on the job, he began his daily report, "I'm a weatherman, I talk weather a lot, but I'm going to rhyme now, whether you're ready or not!"

It took a year for Kosir's segments to become viral sensations. "The Rapping Weatherman" was featured on *The O'Reilly Factor* and *Inside Edition*; Ellen DeGeneres and Ryan Seacrest tweeted about his forecasts. He parlayed the fame into a job at KRON, an NBC affiliate in San Francisco. However, after a disagreement with his new boss during his first week, Kosir found himself yet another unemployed weatherman in a tanking economy. These days he's trying to rehabilitate his career as the forecaster for KMVT's *Rise and Shine* in Twin Falls, Idaho. And while Idaho lacks the glamour of the Bay Area, Kosir, 27, remains hopeful of returning to Big Weather. "It's still a dream," he says. "I still hope to someday get there."

Kosir isn't the only weatherman down on his luck. The economy and the Internet are conspiring to diminish the position. The National Weather Assn., an organization of professional meteorologists, has seen a downturn in membership renewals over the past few years, from approximately 3,000 in 2006 to about 2,700 in 2010, according to NWA Executive Director Stephen W. Harned. "TV meteorologists have really felt the impact of the recession," says Harned. It's particularly troubling since 2010 was characterized by extreme weather events, and the first weeks of 2011 have been just as severe. On New Year's weekend alone, 40 tornadoes touched down in the U.S., killing seven and wreaking some of the worst atmospheric carnage in 50 years. Earlier this month a Midwestern snowstorm competed for national headlines with the protests in Egypt—and even the Super Bowl. The boon was absorbed by The Weather Channel, the 29-year-old climate behemoth, which saw its ratings jump as much as 62 percent in mid-January. Says Harned: "Anywhere from a third to half of people who graduate with degrees in meteorology this year won't be able to find a job."

"In the blink of an eye, the entire model has changed," says Paul Douglas

Douglas, front and center, leads a well-coiffed team of meteorologists at WeatherNation, a weather outsourcing enterprise



It's a far cry from the glory days. "The TV weatherman has always been one of the best, most secure jobs," says Willard Scott, who presented the weather on *The Today Show* from 1980 to 1996. "They change anchors, they change the set, producers come and go. But the weather person hangs on forever!" Alas, these days, smartphones, widgets, and in-elevator TVs displaying the forecast have decreased the need for weathermen. According to a 2010 poll by media consulting firm Frank N. Magid Associates, while the majority of weather watchers check local forecasts on TV, 87 percent also seek updates on the Internet—a number likely to rise in the coming years.

This change has made it easier for networks to part with their forecasters. In 2008 and early 2009 several major networks—including NBC, CBS, and The Weather Channel—initiated significant layoffs in their news divisions. Dozens of weather anchors across the country, from major network affiliates in New York, Chicago, and San Francisco to smaller stations in Denver and Birmingham, Ala., lost their jobs. "In the blink of an eye, the entire model has changed," says Paul Douglas, 52, who spent more than a decade as the weathercaster for WCCO, a CBS affiliate in Minneapolis. In April 2008, Douglas was let go for, he says, "making too much money at a time when TV stations were panicking during the depths of the recession." Yet Douglas insists this was a blessing: "a wake-up call for everybody in this business."

The time has come, Douglas believes, for weathercasters to reinvent themselves. A month after he was fired he co-founded WeatherNation, which he describes as an "outsourcing weather company" that provides Internet-powered content—with broadcasts read by an anchor—for TV stations that can't afford

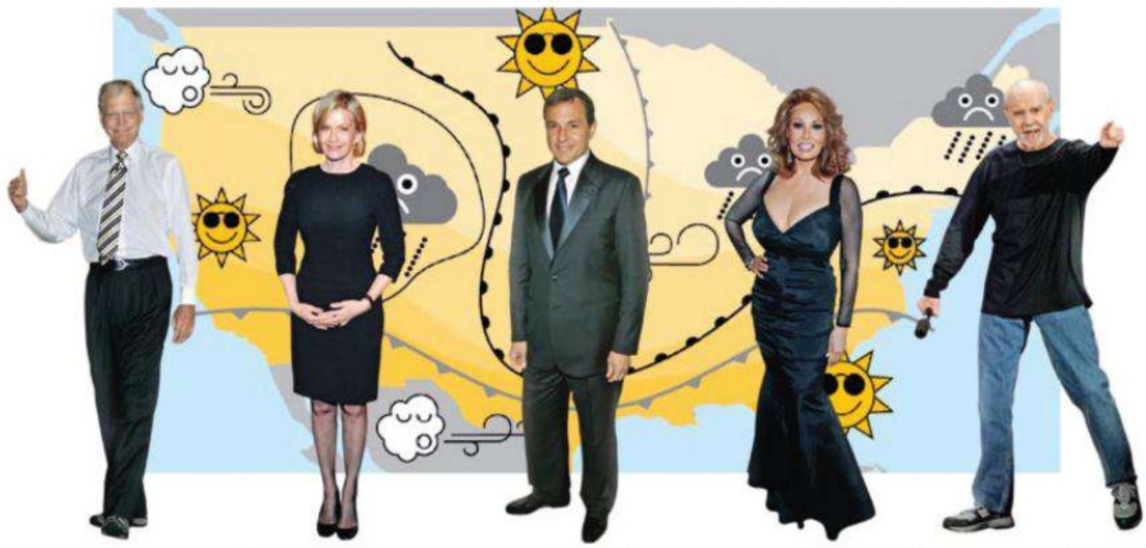
Best (Mostly Real) Weatherman Names ▶ **Skip Waters:** When he was hired by WCTI-TV in New Bern, N.C., in 1982, the says the weather anchor at WCNC in Charlotte. ▶ **Storm Field:** The retired WWOR weather legend was named by his meteorologist dad.

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The Sun'll Come Out Tomorrow

A career in the weather business isn't for everyone–including these alums



FROM LEFT: JEFFREY UFBERG/WIREIMAGE; HILGER/BLOOMBERG NEWS; BRYAN BEDDER/GETTY IMAGES; SCOTT WINTROW/GETTY IMAGES; BRYAN BEDDER/GETTY IMAGES; PAUL DRINKWATER/NBCU PHOTO BANK VIA AP IMAGES

David Letterman
The former weatherman at Indianapolis's WLWI once warned viewers about impending hail "the size of canned hams."

Diane Sawyer
Today she's the esteemed anchor of *ABC World News*. In the late '60s she was the "weathergirl" for WLKY in Louisville.

Bob Iger
In the early '70s the Walt Disney chief was a weatherman at an ABC affiliate in Ithaca, N.Y. In his words, he was "not a good one."

Raquel Welch
Before she was Raquel Welch, she was Raquel Tejada, the weathercaster for the morning *Sun-Up* show on San Diego's KOTV in the early '60s.

George Carlin
The comic's big break occurred in the '60s as Al Sleet, the "Hippie Dippie Weatherman," on *The Ed Sullivan Show.*

a weatherman. So far, clients include the Gannett media group and select Fox networks. In a poetic twist, Douglas's company now supplies weather reports for KARE 11 in the Twin Cities–placing him head-to-head with his former employer.

Yet Douglas's second act may end up being a blow to the weathercasting profession. The typical cost for WeatherNation's services–including radar and satellite imagery, interactive maps, mobile application data, and on-air talent–starts at $12,000 per year. The average annual salary of a weatherman, according to the Radio Television Digital News Assn., is $62,300. And they don't come to work with their own interactive maps. "We grew revenue by 56 percent last year," says Douglas, who expects to turn a profit in 2011 and expand his staff of eight full-time anchors. Douglas is positioning his business to cash in on what he sees as the future of the industry: personalized weather. Soon, he claims, people will want weather information "tailored for our GPS locations, lifestyles, calendars, anticipating our needs in advance"–all without ever turning on the TV.

Joe Bastardi agrees. As a senior forecaster for State College (Pa.)-based AccuWeather, he occasionally discusses the weather on networks such as CNN and Fox News. Yet TV, Bastardi confesses, is merely a platform to cultivate his own burgeoning weather enterprise. His main occupation, he says, is providing personalized forecasts for corporate clients, none of which he'll name. "The good Lord made me to forecast the weather," Bastardi explains, "he didn't make me to be a TV star." It's a media strategy he says he learned from Bruce Springsteen. "When Springsteen first put his music out there, he didn't want it on TV," he says. "And then he figured, maybe I can use this medium to share my message with more people. It's the same way with me."

"The good Lord made me to forecast the weather ... [not] be a TV star," says Joe Bastardi

Paul Douglas knows it isn't always as easy as the Boss makes it seem. Last May, in a partnership with Dish Network, he launched The Weather Cast to challenge The Weather Channel's monopoly. It lasted four days, making it one of the shortest-lived networks in TV history. "I want to believe meteorologists are up there with bar owners and morticians," says Douglas. "There will always be a need for what we do." Sam Champion, the weatherman on ABC's *Good Morning America*, isn't sweating, though. He has a theory. "There are 50,000 places to get cupcakes," he explains, "but you probably have your favorite. We provide a certain kind of cupcake." Ⓑ

general manager "held a 'Name the New Meteorologist' contest," he remembers. ▶ **Larry Sprinkle:** "My honest-to-goodness real name,"
▶ **Karl Spring:** The former Fox 21 News meteorologist in Duluth, Minn., says one boss "wanted me to change my name every 90 days."

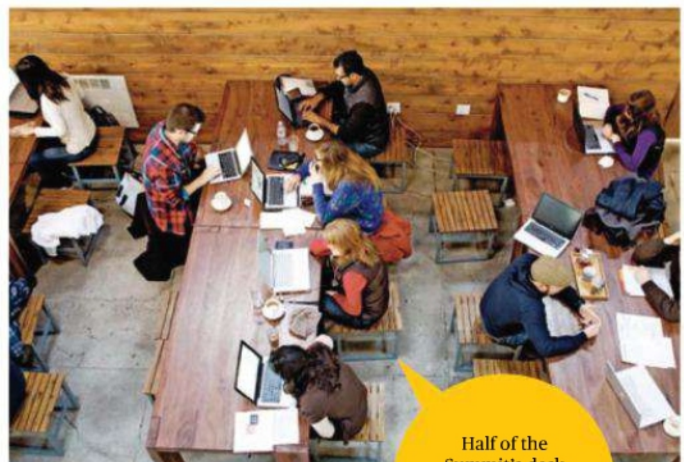
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I/o Ventures-funded companies set up shop above the café



The Summit's neighbors include Dave Eggers' twee literary juggernaut, McSweeney's, and a taxidermist





Half of the Summit's desk spaces are contracted out to Web entrepreneurs

Venti Capitalism

A San Francisco café that fuels startups with cash and endless macchiatos. *By Matt Haber*

With its copious power outlets, Gouda-wrapped meatballs, and a curated magazine rack featuring vintage Steve Jobs covers, the Summit café sits at the intersection of San Francisco's three most conspicuous tribes: techies, foodies, and yuppies. Yet what separates the Summit from being just another Wi-Fi boîte is the dual-purpose nature of the 5,000-square-foot space. One floor above the Laptop Mafia, the café features a cluster of offices where groups of programmers and developers toil away in an effort to launch the next Twitter—or at least the next OkCupid.

A café for "artisans, foodies, digital entrepreneurs"

Created by i/o Ventures, a Bay Area startup accelerator comprising former executives from MySpace, Yahoo!, and file-sharing site BitTorrent, the Summit is equal parts Bell Labs and Central Perk—and probably the country's first official coffeehouse tech incubator. Every four months, i/o selects and funds a handful of small tech ventures to the tune of $25,000 each in return for 8 percent of common stock. In addition to the cash, each team gets four months of office space at the Summit, mentoring from Web gurus like Russel Simmons of Yelp, and discounts on all the Pickle & Cheese Plates or White Snow Peony Tea they could possibly need. Since the café opened on Valencia Street last fall, two companies have already been sold, including damntheradio, a Facebook fan management tool. To hedge against any potential risk, i/o also rents half of the Summit's other desk space to independent contractors and fledgling Web entrepreneurs. It's even experimenting with an arrangement in which customers can pay $500 for a

PHOTOGRAPHS BY JONATHAN SPRAGUE FOR BLOOMBERG BUSINESSWEEK

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dedicated desk—on top of a $250 membership fee.

While the Summit isn't the first café to spawn a startup, it's the first to professionalize the process. Every surface of the eatery's communal tables is occupied with MacBooks, power cables, and messenger bags. "You get cabin fever just working from your house all the time," says Ashwin Navin, the floppy-haired, 33-year-old veteran of the Yahoo! Corporate Development group and one of i/o's four principals. "Sometimes, being able to grab your laptop and enter a café, even if it's a Starbucks, for crying out loud, with the sound of Frappuccinos and other kinds of stuff, and intentionally uncomfortable furniture. ..." Navin's voice trails off. "Sometimes you just gotta go."

No one would ever mistake the Summit for a Starbucks. The café was inspired by sociologist Ray Oldenburg's "third place" theory. (*CliffsNotes* version: Everyone has a home, a first place, and an office, a second place. They need a third.) Desi Danganan, the Summit's boyish, 35-year-old managing director, and his creative team—which includes Freddy Anzures, a member of Apple's original iPhone design group—have taken great pains to turn this third place into what Danganan calls "a creative commons" that could pretty much only exist in San Francisco. In a nod to the city's fixation on the locavore movement, a map hangs beside the food counter showing the distances various ingredients traveled to make it onto the menu. The café only uses coffee beans from Blue Bottle, the über-hip local microroaster.

While the Summit is noticeably more polished than many of its neighbors—i/o spent nearly $2 million to get it off the ground—it somehow fits within the rapidly gentrifying, post-collegiate confines of the Mission District, home to the unmarked offices of independent publisher McSweeney's, a custom bike shop, and a hipster-friendly taxidermy store. "We're trying to gather together freethinkers, artisans, foodies, digital entrepreneurs," says Danganan. And, of course, all manner of snobs. Local bloggers mocked the Summit this fall after the café advertised on Craigslist for baristas who "demonstrate a love of coffee and the ability to craft with care and a sense of urgency." A month after its opening, gallery director Marky Enriquez launched the Peek, a rotating exhibit of works hung on the café's curvilinear, distressed wood wall. Architect Heidi Liebes says she chose the wood to warm up the space—not that patrons seem keen to look up from their laptops long enough to appreciate it.

Among the startups benefiting from i/o's investment are three piggybacking on the Facebook operating system: Appbistro, a marketplace for third-party applications; AppRats, which helps viral video stars maximize their 15 megabytes of fame; and damntheradio, a site that helps marketers target fans through their taste in music. In January, damntheradio was acquired by online marketing company FanBridge for a low-seven-figure amount,

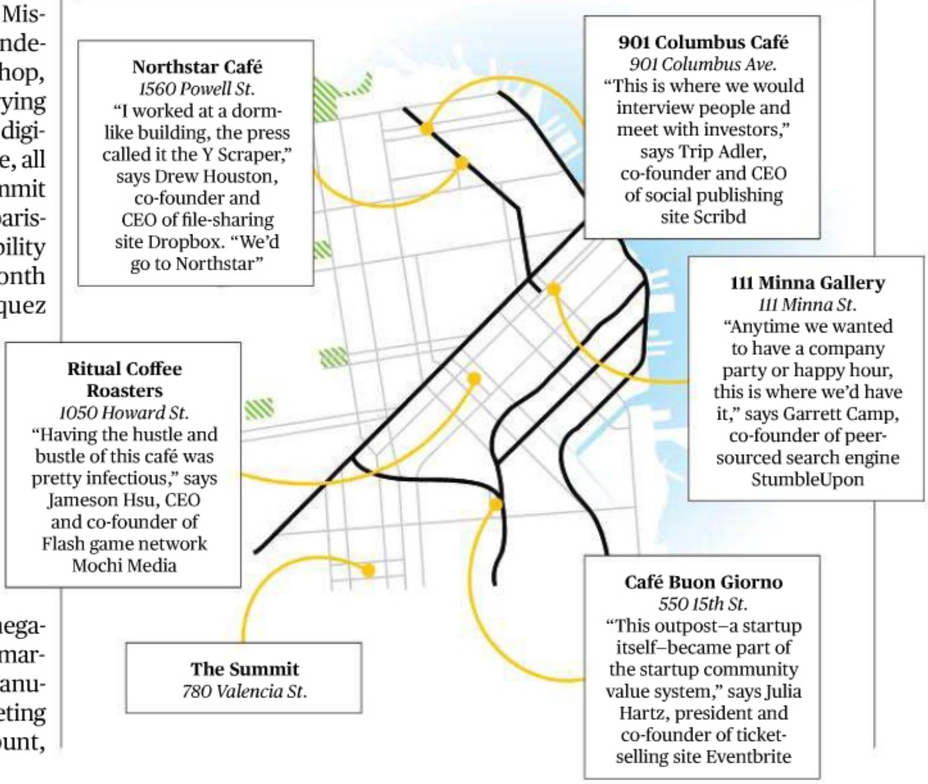
"You get cabin fever just working from your house all the time," says Ashwin Navin, an i/o principal

according to TechCrunch. I/o-sponsored companies that focus on the world outside Facebook, if such a place exists, include Anomaly, which serves Web content personalized to users' preferences. There's also SocialVision, which helps companies leverage online video through social networking, and Skyara, a site that helps users connect with such offline activities as a master workshop with a "parking ticket consultant" or lessons in making balloon animals. Somehow this may become a multimillion-dollar business.

While the Summit is planning on adding a bar later this year, it remains, for the moment, another outpost of Laptopistan. "Right now, it's definitely laptop heavy," Enriquez says. According to Liane Al-Ghusain, the gallery's 23-year-old chief copywriter, "It does feel like an assembly line." Albeit with some perks. "Some days it's great, some days it's not so great," says Nalin Mittal, the 33-year-old chief technology officer and co-founder of AppBistro. "On the whole," Mittal continues, "it's pretty awesome." Ryan Merket, Mittal's 29-year-old partner and chief executive officer, agrees, but he points out one considerable downside of working in a café. "About 3 p.m. or 4 p.m., when the cookies start getting baked—that's probably the biggest distraction," he says, sitting atop a green beanbag in one of the Summit's meeting areas. "I've definitely put on some weight." B

Launching Pads

Local coffee bars and hangouts have long served as (unofficial) creative incubators for San Francisco tech startups. —*Spencer Bailey*



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Olivia Newton-John speaks!

Sweat the Technique

The way you act on the treadmill or the exercise bike can say a lot about you. *By Tim Murphy*

Olivia Newton-John was on to something when she crooned, "Let me hear your body talk," in her 1981 gym anthem *Let's Get Physical*. Exercising is more than just a leisure activity; your gym behavior says a lot about you. Take the alpha fitness freaks who crunch their way to six-pack abs at ungodly morning hours. "They may be doing this to keep their minds sharp for the day," says body-language specialist Joe Navarro, author of *What Every Body Is Saying*. "They are very well-regulated individuals who are dedicated to themselves."

Today, 21 percent of American men and 16 percent of women are likely to exercise on any given day–and for about four hours per week–according to the U.S. Bureau of Labor Statistics. Soon more of the U.S. workforce might be motivated to get physical thanks to a growing interest in corporate wellness programs. "I'm hearing a lot of people at my gyms saying their jobs are encouraging them to join a gym to prevent their health-care expenses down the line," says David Barton, owner of an eponymous health club chain.

With this in mind, *Bloomberg Businessweek* observed 100 people at an upscale Manhattan fitness club from 7 a.m. to 9 a.m. on a recent Monday. What follows is a breakdown of common gym-goer behavior as analyzed by an expert panel: Navarro; Barton; David Givens, author of *Your Body at Work*; Patti Wood, author of the forthcoming *Snap! Making the Most of First Impressions*–and, of course, Newton-John, the former spandex devotee and co-developer of breast self-exam device the Liv. **B**

9% *(of people observed)*

Morning Show Smiler

"It's escaping the pain you're going through," Givens says of people who beam delightedly while watching CNN's *American Morning* or MSNBC's *Morning Joe*. "The rapport with anchors is comforting," says Navarro.

18%

Elliptical Extremist

Whippet-thin women in hot pants who grind it out hard and fast on the elliptical are "strung out on the physical high," Barton says. "These women have not gotten enough sex lately," notes Wood. "They're taking it out on the machine."



8%

Personal Trainer Eye-Batter

Those who enjoy being adjusted by buff trainers are getting the "emotional payoff" from human contact that they're "not getting outside the gym," says Givens. Wood: "Trainers touch you in abnormal places, so the trainer can become a little date."

16%

Obnoxious College Shirt Wearer

Those who show off their alma mater are unsubtly indicating "my brain is way fitter than your brain," Givens says. "Work clothes express identity," according to Barton. "With workout clothes, it's harder."

Other Notable Yet Less Common Gym Behaviors ▶ MUSCLE MILK CHUGGER / **Givens:** "He's really into himself
RACERS / **Givens:** "They're fired up to the max. They're probably like that at work." ▶ STAIRMASTER STRETCHERS / **Navarro:** "Unlike

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7%

Pickup Artist

"You're saying, 'I'm sexually available,'" Wood says of those who try to impress the opposite sex by pumping major iron or ramping up the treadmill extremely fast. "Perspiration, that flush on your skin, can be very stimulating."

6%

Finger Exerciser

Mobile device users who gym-text are "intimidated by the strangers," notes Givens. Barton says they're "control freaks." Wood adds, "They feel like Superman or Superwoman." Newton-John: "I couldn't do that. I'd fall off."

6%

Sensual Mirror Starer

Some workout fiends seem to be making love to themselves as they stretch or lift weights in front of mirrors. "They're narcissists," Givens says. "These folks get motivated by their own image." Wood agrees: "They're dating the mirror."



13%

Distracted Trudger

"They don't want to tell their brain that they're working out," Wood says of treadmill walkers who slog along reading the newspaper or a Kindle. "This is rationalization to tell themselves they [exercised]," says Barton. "They're assuaging their guilt."

11%

Misery Wheezer

Holding on to a machine for dear life suggests the exerciser would "rather not be there," says Givens. "There's no payoff." Barton: "Maybe it's indicative of how they go through life. They should get off the machine—and get in touch with their bodies."

4%

Flamboyant Hand Gesturer

People who pump their fists, snap their fingers, or do jazz hands while doing cardio? "It says, 'I am here, look at me,'" Givens says. Newton-John agrees: "I don't hold on when I walk, but I don't swing. I don't want people to look at me."

and his power." ▶ **BLUE-TOOTH TALKERS** / **Givens:** "Their devices allow them to bring their social group with them." ▶ **TREADMILL** dogs, they can't pee and mark their territory so they touch the machines." ▶ **WILD ARM SWINGERS** / **Barton:** "They may just be bats--t."

ILLUSTRATION BY MATT JOHNSTONE; JOHN: EVERETT COLLECTION

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Etc. One True Thing

The Little Black Dress



A ladylike investment piece that's ready for everyday office wear

By Nandita Khanna

The Want: The perfect L.B.D.–not too long, not too short–that'll take you from a 9 a.m. meeting to a chichi client dinner. It should be demure, dress-up-able, and can't break the bank.

The Get: Boden's Pleat Detail Wool Dress ($188, bodenusa.com). This structured black shift dress from British retailer Boden hits all the right sartorial notes. It's wool and lined, which maximizes warmth and minimizes the see-through factor. The cap sleeves are also universally flattering. Even with a cardigan or blazer thrown over it, the pleat detail at the neckline dresses it up just enough. B

RING LEADER

Eye-catching cocktail bling to suit any style



Minimalist

Add a touch of subdued shine with Gorjana's hammered 18-carat gold Chloe ring, which looks much more expensive than it is. Wear it with no other jewelry and you'll still stand out. *$95, gorjana.com*



Vintage Fake-Out

Exude a deco vibe with this gold, enamel, and peridot Dragon Scale ring from Kara by Kara Ross. Everyone will think you scored it at a Palm Springs flea market. *$190, kararossny.com*



Trendsetter

The leather cutouts and richly hued stones make this Multi-colored Cluster ring a scene stealer. Go figure: It's from Hollywood starlet Nicole Richie's House of Harlow jewelry line. *$110, charmandchain.com*



Romantic

This Serpent ring from Ann Taylor has a "borrowed from your (very chic) grandmother's jewelry box" quality that goes well with all outfits, especially dresses and billowy blouses. *$58, anntaylor.com*

DRESS: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEK

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Etc. Hands On

Going Rogue

Make your office mobile with these cordless tech gadgets

Caffeine Fix



mypressi Twist

This gavel-size gadget produces an espresso shot in less than two minutes. Just add ground coffee and hot water, pull the trigger, and—presto—back to work. *$169, mypressi.com*

Scanner



Planon SlimScan

Make filing an expense report kind of fun with this tiny scanner. Stash it in your wallet to scan receipts, and you'll escape the tyranny of the post-business-trip crumpled-paper pile. *$120, planon.com*

E-Mailing Aid



Quirky Digits

Invented by a Chicago-based twentysomething who knows about the cold, these silicone pads attach to your gloves with pins, letting you operate touch-screens without removing your mitts. *$14, quirky.com*

Keyboard



Celluon Magic Cube

Effortlessly sync your smartphone, iPad, or computer with this Bluetooth-enabled box that projects a laser keyboard onto flat surfaces. It really works—especially if you're a careful typist. *$199.99, celluon.com*

Speaker



Science + Sons Phonofone III

Set your iPhone inside this electricity-free, gramophone-inspired megaphone, and the volume from the phone's speakers will quadruple, to about 60 decibels. *$195, scienceandsons.com*

Light



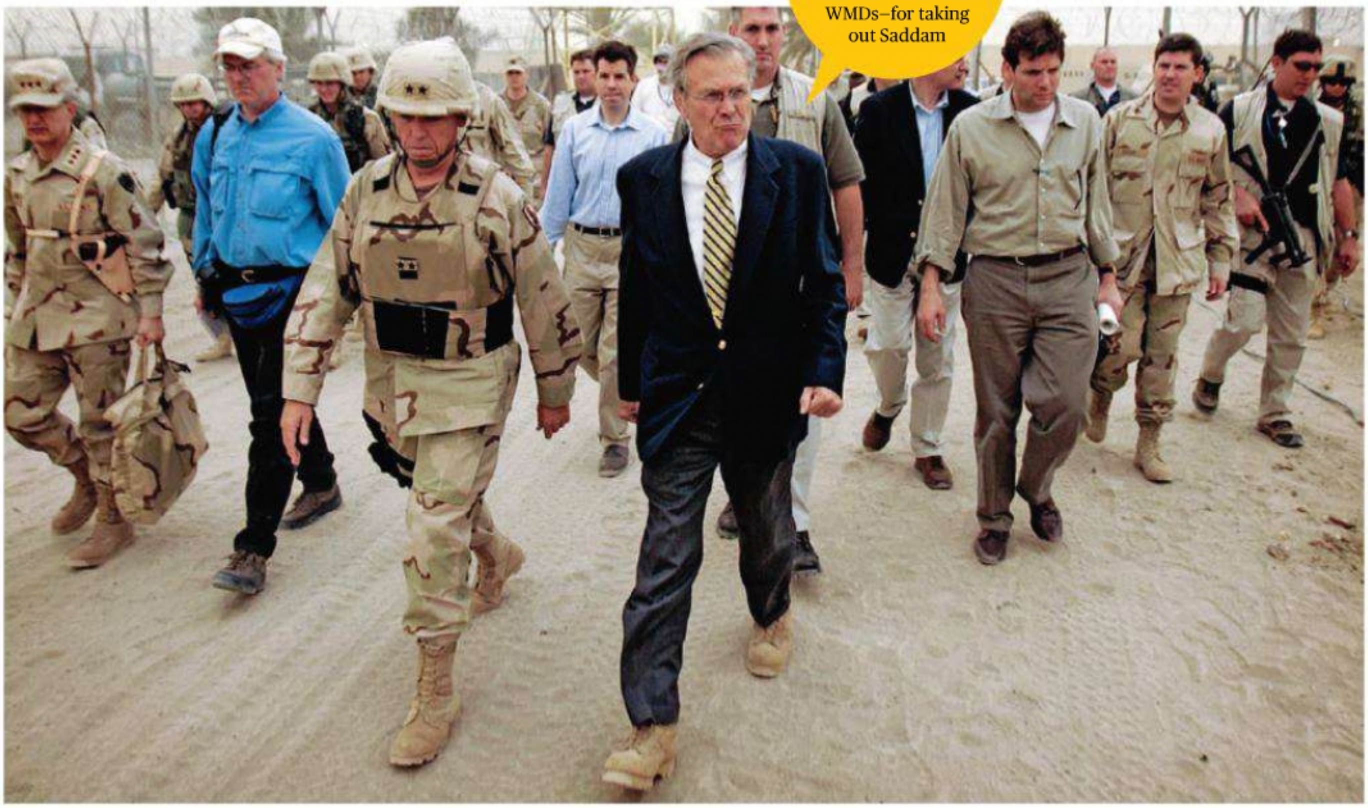
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—*Steve Mazzucchi*



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Rumsfeld, shown at Abu Ghraib in 2004, writes that there were many reasons—other than WMDs—for taking out Saddam

The Rummy Diaries

Donald Rumsfeld's tell-all offers a nuanced account of the Bush years. *By Christopher Buckley*

Donald H. Rumsfeld has a résumé that might make even God a bit envious. Princeton wrestler; Navy pilot; U.S. representative by the age of 30; counselor to the President of the United States; U.S. ambassador to NATO; White House chief of staff; chief executive of two *Fortune* 500 companies. He was the youngest Defense Secretary in U.S. history—and also the oldest.

Yet, to paraphrase Euripides: Those whom the gods would destroy, first they endow with golden résumés. Rumsfeld's stewardship of George W. Bush's Iraq War has left his once-undented reputation looking like it was hit by a roadside IED. His critics blame him for—where to begin?—going after Saddam Hussein in the first place, the lack of much-touted WMDs, the looting of the Iraqi National Museum, the obscenities of Abu Ghraib, water-boarding, Guantánamo, and pretty much everything else. By the time Bush asked for his resignation—one that Rumsfeld writes he'd already twice volunteered—Rummy had been teed up by journalists, quick-draw historians, and the left-wing punditariat as a Robert Strange McNamara 2.0. They even kind of look alike.

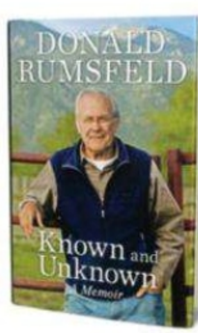
Rumsfeld may also be the only cabinet secretary in American history to have blurted out spontaneous Zen koans in the midst of press conferences. His now famous utterance about "known knowns"—and "known unknowns" *and* "unknown unknowns"—has not only been turned into poetry (albeit by mischievous satirists) but has also been set to music. Now it's the title of a book.

I've known Don Rumsfeld for 15 years, and I approached *Known and Unknown* with some trepidation. I was against the Iraq War from the outset. After its brilliant and efficient initial phase, I became deeply disillusioned. Like many of my generation, I felt I'd seen this movie before, in the late 1960s. I'd read Bob Woodward's books and a number of others that filled me with anger and left the unpleasant aftertaste that a man I admired had plunged the country into another awful quagmire. And that he'd done it, moreover, with what his old boss might call "Grecian" hubris.

Known and Unknown changed my mind. Rums-

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Known and Unknown: A Memoir
By Donald Rumsfeld
SENTINEL
832 pp, $36



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feld doesn't suffer from Testosterone Deficit Syndrome, and he comes at the reader with his jaw full out. Yet even his critics will have to strain to assert that he's dishonest. He takes his share of blame for the Administration's overemphasis on WMDs. (There were, he writes, many other valid reasons for taking out Saddam Hussein—among them, Saddam's more-than-numerous violations of U.N. resolutions.) He makes no claims to being a PR genius and acknowledges that the "Old Europe" crack didn't help. But he insists America did the right thing in Iraq and that he would do it again. He believes that Bush 41 should have finished the job on the first go-around, but he doesn't buy into the Oedipal theory, much in vogue, that Bush 43 went back to upstage his old man.

Readers will be reminded that Rumsfeld has been something of a Republican Zelig. *Known and Unknown* opens with his famous 1983 handshake with Saddam in Baghdad. Pages later, he's under rocket attack in Beirut, sidestepping pools of blood at the presidential palace. Then there he is—oh, *so* wisely—turning down Nixon's offer to head up CREEP, the exquisitely titled Committee to Re-Elect the President. Later he's in the White House Situation Room on Apr. 29, 1975, as Saigon was being evacuated, insisting America not end its saddest engagement with yet another lie.

Later still, he's in the motorcade with President Ford when—look out!—their car is accidentally rammed by four teenagers, leaving Ford with a nasty bump on his head. A few days afterward, as the two left the St. Francis Hotel in San Francisco, Rummy suggested Ford move quickly to the limo so that no one would notice the ding. (Chevy Chase didn't need any more material.) It was Ford's quickened pace that gave Sara Jane Moore a faster-moving target and resulted in her bullet whizzing between the President's and Rumsfeld's heads. What else? Yes, of course: On the morning of Sept. 11, 2001, he was at his desk at the Pentagon when the whole building suddenly shook.

While it isn't always thrilling—meditations on interoffice memoranda don't often make for Tom Clancy-quality suspense—*Known and Unknown* is a meaty, well-written book that will be a primary source for historians. For the truly insatiable, and perhaps the socially challenged, he's putting a zillion supporting documents online. Please, be my guest. Yet this power memoir deserves to be read with the care that went into writing it. Too many Washington tell-alls are dashed off or left to hapless ghostwriters because the—ahem—"author" was racing off to another $100,000 speaking gig in Orlando.

Known and Unknown is also assiduously, almost mind-numbingly footnoted and sourced. Perhaps it's a sign that Rumsfeld has spent enough time in Washington to know most readers start at the index. Here's a short tipsheet of who comes out well, and who doesn't.

At the top of the latter list: Condoleezza Rice. Rumsfeld writes without any flavor of score-settling, but it's pellucidly clear he views her as a disaster from start to finish, both at the National Security Council and the State Dept. Others who may want to chew a Pepto-Bismol tablet or two before looking themselves up: Colin Powell, George Tenet, Jacques Chirac, Richard Armitage, Paul Bremer, former *Newsweek* editor Mark Whitaker, Dick Durbin, and more or less the entire U.S. State Dept. The praised include George W. Bush, Dick Cheney, Paul Wolfowitz, George Shultz, and the U.S. military (with a few high-level exceptions).

Rumsfeld's essential theme is that Americans don't tolerate long engagements. (Though the country managed a long one, albeit of a different kind, between 1949 and 1989.) He cites, and dwells on repeatedly, America's rapid pull-outs from Beirut after the Marine barracks bombing in 1983, and from Somalia following the "Black Hawk Down" episode a decade later. These departures give assurance to our enemies, he writes. Rumsfeld explains that Saddam told his interrogators he viewed America as a "paper tiger," though the Lion of Iraq may have entertained a different view once the noose was put around his neck. The Rumsfeld Doctrine is, of course, contestable—what were we doing there in the first place, anyway?—but he defends it nevertheless with muscle and vigor.

A thoughtful man and an avid reader of history, Rummy delights in collecting maxims, which he publishes privately as Rumsfeld's Rules. Many of those nuggets are sprinkled throughout *Known and Unknown*, and provide a glimpse into the inner workings of the man. Some of the most telling include: "Plans are worthless, but planning is everything" (Dwight Eisenhower); "If you get the objectives right, a lieutenant can write the strategy" (George Marshall). The next few hail from his seven years running G.D. Searle, during which profits rose from $35 million to $162 million: "What you measure improves"; "You get what you inspect, not what you expect"; "A's hire A's; B's hire C's." It has been a pleasure to know Donald Rumsfeld. Thank God I never worked for him.

During the worst moments of the Iraq War, though, I came across another one of Rumsfeld's bits of Zen: "If you can't solve a problem, make it bigger." I loved that line, and quoted it often, adding with a laugh, "Well, I guess *that* worked." I still like the line, but I'm no longer laughing quite so hard. B

Words of Mass Destruction

...And other unknowns about known figures from Rumsfeld's index



"Bush approved an $18 billion increase for the department, about half of what I had recommended. I was disappointed. ... By late summer I was not gaining the traction necessary to carry out the President's plans." *p. 332*



"Rice was something of an outlier in the Bush [National Security Council]. ... while she had served on the NSC staff in the earlier Bush Administration, she had not had senior-level experience." *p. 325*



"The media image of Powell battling the forces of unilateralism and conservatism may have been beneficial to Powell in some circles, but it did not jibe with reality." *p. 323*



"I wished for a moment [at my farewell ceremony] that more people could know Dick as Joyce[Rumsfeld] and I did. There are facets of his personality that the public rarely, if ever, had a chance to see." *p. 709*

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Gary Bettman

"The conventional wisdom was that no sports league would ever cancel an entire season. And if they did, they'd never live to tell about it"

As the National Football League begins labor negotiations, the National Hockey League commissioner recalls his last lockout



PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK

When I became commissioner in 1993, hockey had enormous growth potential. But from an economic standpoint, the league was in trouble. We tried to address the issues in negotiations with the players' union in 1994. We lost half a season and didn't fix the problems. The competitive balance was off. We had teams with $80 million payrolls and teams with $20 million payrolls. It was not sustainable.

Prior to the collective bargaining agreement running out in 2004, it was clear that the players' union's strategy was to tough it out. The conventional wisdom was that no sports league would ever cancel an entire season. And if they did, they'd never live to tell about it.

Coming into negotiations, the first hard choice we had to make was that we weren't going to open the 2004-05 season. I think the union expected that. The second was announcing in February that the rest of that season wasn't going to be played and that we wouldn't open the next season without a collective bargaining agreement. We were serious about the need for cost certainty. I was not happy about having to prove we meant what we said.

During that period we went about changing our business. We looked for new ways to market ourselves, and we retooled the game so that when we came back with a better economic system we'd also have a faster, more entertaining game for fans. After the lockout, our sponsors and fans hung in there. At the time, though, ESPN didn't share our vision. We signed a cable TV partnership with Versus, or what was then Outdoor Life Network. We would not be nearly as well-positioned as we are now if we hadn't changed. We're headed toward six years of record revenues and attendance.

My job includes being the lightning rod. I understand that commissioners typically are not beloved. Having to cancel an entire season was the toughest choice I've had to make. But we had to fix the problems. B *—As told to Diane Brady*

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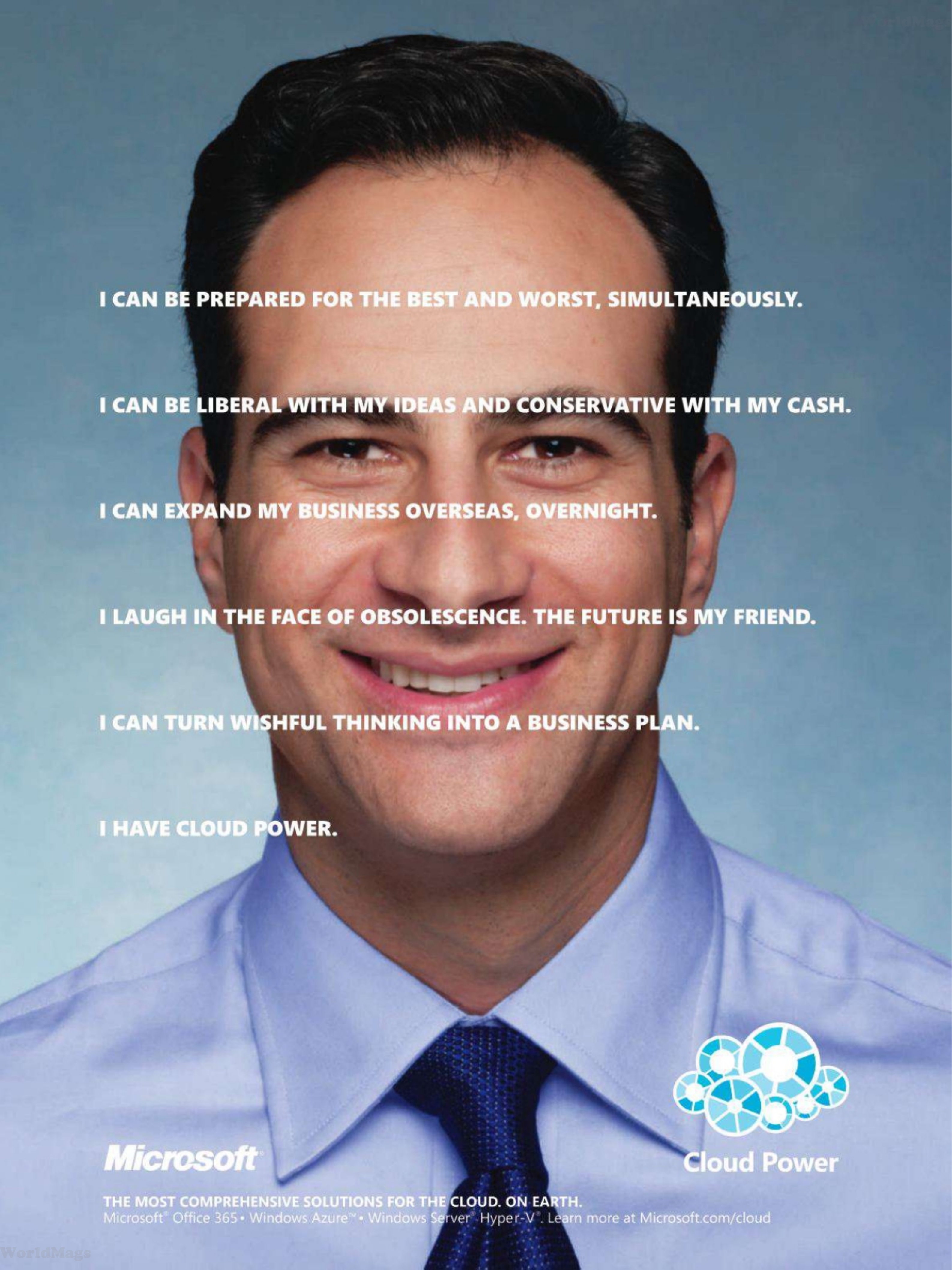
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